

**A CASE STUDY OF THE PLANNING PROCESS OF REAL ESTATE
DEVELOPMENT IN SHANGHAI, CHINA:
A HONG KONG DEVELOPER'S PERSPECTIVE**

by

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Submitted to the Department of Architecture
in Partial Fulfillment of the Requirements for the Degree of
Master of Science in Real Estate Development

at the

Massachusetts Institute of Technology

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ABSTRACT

This work describes the planning process of current real estate development in Shanghai, China. The subject of the case study is Hang Lung Development Company, Ltd. of Hong Kong, which has two projects in progress within Shanghai and a third one in contract negotiation stage.

To provide a general context for understanding Hang Lung's strategy and approaches, the development environment in China is first reviewed in terms of historical, political, and economic dynamics. The structure of relevant government agencies, their regulations and decision processes are outlined, with emphasis on the land-use contracts. Various forms of joint ventures are described.

Hang Lung's strategy is to focus on a few choice projects in the most important metropolitan areas earmarked for special economic development. Two projects are discussed as detailed case studies. The "Siping Lu" project marks this developer's first entry into China. Its land and construction costs are about US\$48 million. This was used by the developer as a pilot to become familiar with the legal system and working guidelines, and to evaluate various collaborative relationships with venture partners and design institutes. The equity joint venture established between the foreign investor (in this case Hang Lung) and its partner in China is discussed in detail.

"Xujiahui" is a second, much more ambitious project whose land and construction costs total approximately US\$500 million. This is a multi-use (residential, retail, and office) complex occupying 3.3 million sq. ft. located above a new subway station in one of the most sought after sites offered for development in Shanghai. Details about the contract, the nested joint venture arrangement, and the make-up of the design team are presented. Finally a potential project of comparable size to Xujiahui is briefly discussed. Although this project is just in the contract negotiation stage, its method of site acquisition is unique and instructive.

Thesis supervisor: Thomas A. Steele
Title: Chairman, Center for Real Estate

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Special thanks to my husband, Eric K. Lee, for his encouragement, intellectual challenge, friendship and support; without him these last twelve months would have been impossible. Finally, to our wonderful daughter, Claudia: Thank you for letting Mommy do what she wants to do.

BIOGRAPHICAL SKETCH

MIU-YU CECILIA WAN

Cecilia grew up in Hong Kong. She began her architectural studies at the University of Hong Kong, transferred to North Carolina State University at Raleigh in her Junior year, and graduated as Bachelor of Architecture. She practiced in Raleigh and Toronto on campus planning and architecture, and spent a year studying and traveling in Germany and Europe. Upon returning to the United States, she resumed her architectural practice in Bend (Oregon) and Philadelphia as a Registered Architect on a variety of commercial and residential projects. These included the Bend Redmond Airport in Oregon and the Princeton Forrestal Village in Princeton, New Jersey. From 1986 to 1991, Cecilia held the position of Associate at CBT Architects in Boston, where she was a key designer in the Prudential Office Building project in Boston, a Metropolitan Boston Transit Authority train station, and a residential complex in historic Salem, Massachusetts. More recently, as Senior Architect at Ellenzweig Associates in Cambridge, she was principal designer of a rare book library and a museum for scientific instruments at the Massachusetts Institute of Technology. Her experience encompasses large-scale commercial work, institutional design, campus architecture, residential buildings and interior design.

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I. INTRODUCTION

I.A. BACKGROUND

China is undergoing a period of social, political, and economic changes unparalleled in its history, and, given its population base, perhaps unparalleled in the history of the world. Economic growth in the 1990s has not only been rapid, but accelerating. Earlier this April, the government of China released the fiscal figures for 1992. Real GNP grew by 13%, industrial output grew by 21%, and fixed capital investment by 38%. The impressive growth continues into 1993, with first-quarter figures showing real GNP increase of 14% over the same period last year; the fastest quarterly increase since 1979.¹ Growth of such proportions is particularly remarkable in view of the doldrums in which key Western countries currently find themselves. Many economists predict that China will sustain an average real growth rate of 7% over the next decade even after this initial overheated growth subsides.²

Consequent to this growth is a dramatic increase of demand in goods and services in a country of more than a billion people. Foreign countries have responded by investing in contracts worth nearly 60 billion dollars, of which more than \$11 billion has already been delivered. With the U.S. economy slowly recovering from its recession, China represents an exciting, alternative growth market and investment opportunity for American companies

A number of U.S. companies have already invested heavily in China: Eastman Kodak, Heinz, Johnson & Johnson, the U.S. Big Three automobile companies. They were motivated initially by China's supply of inexpensive labor, a potentially enormous local

¹ "Yuan, a debased currency?" *The Economist* (April 24th 1993), p.35.

² "China, the Emerging Economic Powerhouse of the 21st Century," *BusinessWeek* (May 17, 1993), p.54.

market for their products, and China's eagerness to meet its own ambitious growth targets. More recently, Motorola announced plans to invest an estimated \$400 million in Tianjin in the next three years in manufacturing plants and equipment as well as in research and development facilities.³ Other multinational companies are following suit. Among the most significant agreements recently completed are \$2 billion worth of power plants with Wing-Merrill, a \$1.2 billion natural gas project with ARCO, and a telecommunications and high technology business with AT&T estimated to be worth more than \$1 billion.⁴ Such news symbolizes those investors' confidence in China as an emerging, solid economic market capable of supporting sophisticated, vertically integrated industries.

The increasing amount of foreign investment in China is helping drive the demand for new real estate development. Such demand includes commercial office buildings, industrial buildings, retail space, hotels, and residential buildings. From 1991 to 1992, the number of registered real estate development companies in China grew from 3,700 to over 12,400, while the price of commercial property increased 117% in Guangdong Province in the southern part of China.⁵ Obviously, the real estate development environment has become more complex and increasingly competitive. A majority of the successful companies involved in this market are based in China and Hong Kong, the latter benefitting from its close proximity and historical ties with Mainland China. By comparison, U.S. companies have a limited presence to-date, due presumably to uncertainties about the political future in China, and their relative unfamiliarity of the regulatory and cultural aspects of conducting business in this rapidly evolving milieu.

³ Pete Engardio, "Motorola in China: A Great Leap Forward," *BusinessWeek* (May 17, 1993), p.58.

⁴ "China Fever Strikes Again," *BusinessWeek* (March 29, 1993), p.46.

⁵ "Preliminary Draft for the Chinese Real estate Law," *Ta-Kung-Pao* (May 9, 1993) p. 1.

I.B. THESIS OBJECTIVES

Most current information about the real estate development process in China is available only in Chinese, and is rather inaccessible in the U.S. This thesis has been motivated by the need to understand the realities of the development process and, in turn, to help identify opportunities and constraints for foreign parties interested in entering China as potential investors and/or developers. The real estate development process in China is examined from the perspective of one foreign investor-developer. The work is performed as a case study on Hang Lung Development Co., Ltd of Hong Kong. Widely recognized as one of the premier real estate developers in Hong Kong, this company has two projects in progress within China with a potential third in contract negotiation stage. One of them--Xujiahui--is the largest real estate development in design at the time of this writing, and potentially sets the trend for future developments in Shanghai. The up-coming third project is located along the busiest shopping street in the heart of Shanghai, the "No. 1 Street of China."⁶ By special arrangement with the company, the author selected the two projects in progress as the focus of this work, and briefly discussed the third.

Specifically, this thesis seeks to follow the projects in their conception and planning stages. Considered are the development strategies, the planning process, the locations, size, and significance of the projects. Also included is certain information on financial and equity arrangements, and the regulatory and approval processes governing each aspect of the projects.

I.C. APPROACH / METHODOLOGY

The author travelled to Hong Kong and Shanghai to conduct most of the research for this work. Materials and information were obtained from sources in the U.S., Hong Kong, and Shanghai, and included literature review, interviews and discussions with project

⁶ *Guide to Investment & Development for West Nanjing Road, Jing'an District, Shanghai*, (Shanghai: Shanghai Zhong Chuang & Jing'an Commerce Development Corporation, 1992).

teams from Hang Lung and their partners in China, and by attending some of the design and planning meetings and site visits.

I.D. ORGANIZATION

Chapter II provides an overview of economic development in China that is based on literature review. Chapter III describes in detail the case study of the planning process of Hang Lung's projects in Shanghai. By way of background, a description of Shanghai real estate development environment is briefly presented, a more detailed chapter on this topic can be found in Appendix A. This is followed with rules and regulations applicable to the development planning process. Chapter IV summarizes the significant findings of this thesis.

II. AN OVERVIEW OF ECONOMIC DEVELOPMENT IN CHINA

II.A. POPULATION SIZE AND DISTRIBUTION

One in five human beings is Chinese. With a 1990 population of 1.13 billion people, China is the most populous country in the world. In fact, of the thirteen most populous cities in the world, four are in China: Shenyang, Tianjin, Chengdu and Shanghai.⁷ Geographically, China is the third largest country in the world after Russia and Canada.⁸ However, two thirds of the country are mountainous, mainly towards the west. The western highlands are home to only 6 percent of the population.

While the country is primarily agricultural, only one sixth of the country is suitable for agriculture. The arable land is located largely along the eastern coastal region and the flatlands of the three major river deltas--Huang Ho (Yellow River), Chang Jiang (Yangtze), and Zhu Jiang (Pearl River). Not surprisingly, about 450 million of China's population are concentrated in those regions, leading to some of the highest population densities in the world. For example, Shanghai packs 33,200 people per square kilometer (85,988 people per square mile) in its Huangpu District.⁹

II.B. POLITICAL BACKGROUND

China has been ruled by a centralized communist government since 1949. In the 1950s, Mao Zedong launched the first Five-Year Plan aimed primarily to boost heavy industry. However, farm productivity was largely neglected. This campaign was followed by the Great Leap Forward in 1958, a failed attempt at collectivized agriculture. The year 1966 marked the beginning of the Great Proletarian Cultural Revolution, Mao's program that

⁷ "China," *National Geographic Magazine*, July 1991.

⁸ Anthony Walker and Roger Flanagan, *China: Building for Joint Ventures* (Hong Kong: Levett & Bailey Chartered Surveyors, 1987), p. 17.

⁹ Tan Je-Sing, '92 *Shanghai Real Estate Market*, (Shanghai: Office of the Shanghai Municipal Committee for Land Use System Reform, Shanghai Municipal Statistical Bureau, November 1992). p. 4.

sought to purge "anti-revolutionary" elements from the entire population. For the ensuing ten years, education and technological developments were at a stand-still as schools and universities were closed and intellectuals were sent to labor communes. The negative effects of this period have been most far-reaching; China was placed at great disadvantage while other nations engaged in competitive, yet complementary growth in business, science, and technology. After Mao died in 1976, intense power struggle followed between leftists, who vowed to continue dogmatic communist reform in Mao's style, and moderates, who believed that the future of China required fundamental departure from extremism. With the arrest of a group of extreme leftists,¹⁰ Deng Xiaoping consolidated power and emerged as China's de facto leader in 1977. With a moderate, pragmatic approach to guiding China toward recovery and progress, a major policy initiative was launched in 1978 to modernize the economy. An important element of that initiative has been an open door policy designed to attract foreign investment and the importation of technology and expertise.

II.C. THE OPEN DOOR POLICY

While China was closed off to the outside world in the 60's and 70's, China's neighbors enjoy increasing prosperity through hard work and trading with the U.S. and Europe. For Japan and the other "Asian Tigers" of South Korea, Hong Kong, Singapore and Taiwan, trade and the free flow of capital were "the winds that pull their domestic economies along."¹¹ These were countries that had joined the market economy and practised capitalism, a concept that the communist government had opposed since 1949.

Emerging from the destructive decade of the Cultural Revolution, China's new open-door policy was aimed at building a centrally planned, Chinese-style market economy. An

¹⁰ Often referred to as the "Gang of Four."

¹¹ "China belongs to me", *The Economist*, (May 29-June 4 1993), p.13.

implicit objective is to catch up with, and ultimately surpass, the capitalist Chinese neighbors (Taiwan and Hong Kong), and the other successful economies of the world. Major changes have taken place under this new policy shift. China has established new laws legalizing foreign companies to conduct business in China through joint ventures. Economic zones were designated to attract foreign investment on favorable terms, including special structures on taxes and tariffs.

II.D. JOINT VENTURES

In 1979 China began permitting foreign companies or individuals to set up joint ventures with Chinese companies or individuals.¹² Subsequently, the central government expanded, amended, and approved a comprehensive body of laws governing the operation of joint ventures. Four types of joint venture structure exist today in China:

1. **Equity Joint Ventures.** Equity joint ventures pool the financial and management resources of both the foreign investor and the Chinese partner. Both parties share the risks, profits and losses on the basis of their equity investment and benefits.
2. **Cooperative Joint Ventures.** Under this type of agreement, each party brings its expertise to the venture. Usually, the Chinese partner provides the land, labor force, or public utility connections; whereas the foreign investors provide the equity. The agreement will last a specific number of years. At the beginning, the foreign partner may own a large percentage of the venture; the percentage will decrease over the terms of the agreement, until eventually the Chinese partner will own 100 percentage of the entire venture and the property unconditionally. All the terms of the agreement are to be negotiated. A lot of foreign invested hotels are set up under this type of joint venture agreements.
3. **Wholly Foreign-Owned Ventures.** These are wholly foreign-owned companies that are registered in China. They own and operate their company without any

¹² *Shanghai Overseas Investment Manual*, (Shanghai: Shanghai Far East Publishing, March 1992).

Chinese partners. These companies enjoy the greatest freedom in the management of their business. They have the choice of hiring any employees they prefer.

4. **Equity Public Joint Ventures.** These are publicly-owned equity joint ventures that are traded on the stock markets. They are relatively new, and exist at present only in Shenzhen and Shanghai.¹³

Investors who are contemplating forming joint ventures in China should study relevant laws and regulations carefully. Details on that topic are outside the scope of this study.

II.E. ECONOMIC ZONES

China established four Special Economic Zones (SEZs) in August 1980 with a package of favorable terms for foreign investors, consisting primarily of special tax rates, reduced import levies and other charges. The SEZs are situated around the cities of Shantou, Shenzhen, Xiamen and Zhuhai.¹⁴ These areas are intended as focal points for product and process technology transfer, and for infusion of capital and managerial knowledge. In addition, fourteen Coastal Open Cities (COCs) and Hainan Island are also designated for preferential treatments, albeit with somewhat less extensive benefits compared to the SEZs'. These COCs are Beihai, Dalian, Fuzhou, Guangzhou, Lianyungang, Nantong, Ningbo, Qingdao, Qinhuangdao, Shanghai, Tianjin, Wenzhou, Yantai, and Zhanjiang. Figure 1 shows the locations of the SEZs and the COCs. Many foreigners still prefer investing in the older urban cities where residents are more accustomed to a business environment.

¹³ Hua, L.S., *A Hand Book on Working in China*, (Hong Kong: Ming Pao Publishing Press, March 1993), p. 13.

¹⁴ Hua, L.S., *op. cit.*, p.7.

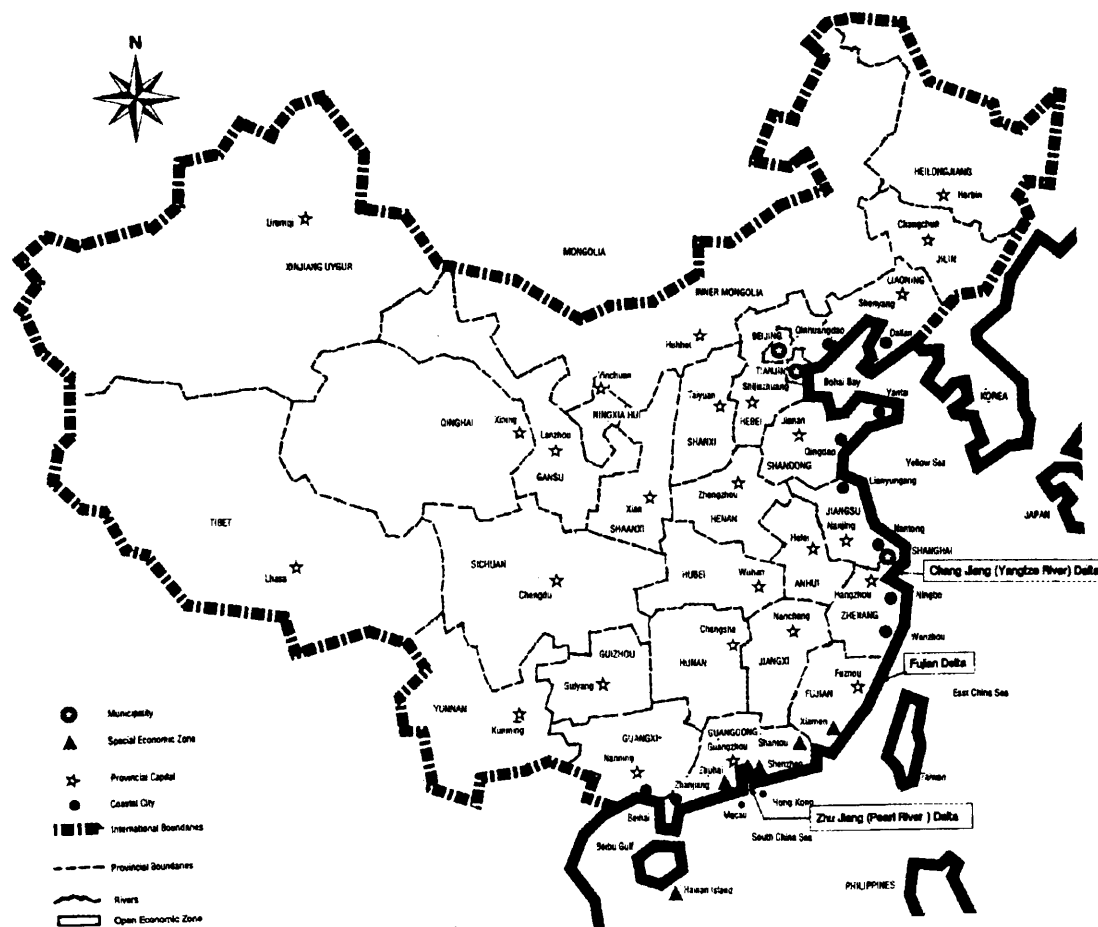


Figure 1. Special Economic Zones and Open Economic Zones in China.

(Source: A. Walker, "Land, Property and Construction in the People's Republic of China.")

Three other Open Economic Zones (OEZs) have also been defined: the Fujian Delta, Changjiang (Yantze River) Delta, and the Zhujiang (Pearl River) Delta. These delta areas are located within major river tributaries, also shown in Figure 1, and function ideally as export-oriented areas. Furthermore, new developments resulting from new and advanced technologies can be accommodated by the surrounding towns. Of the three deltas, the most successful is the Zhujiang Delta located in the southern province of Guangdong. Scattered throughout this province are numerous small villages, the ancestral hometowns to many residents of Hong Kong. The largest group of investors in China are from Hong Kong; accordingly, their investments are for the most part localized in Guangdong.

Similarly, the Fujian province has specifically designated a number of industrial areas to attract Taiwanese investors who maintained close family ties on the Mainland even after their flight from the communist regime.

SPECIAL ECONOMIC ZONES 1980
Shantou
Shenzhen
Xiamen
Zhuhai
THE FOURTEEN COASTAL CITIES AND HAINAN ISLAND
Beihai
Dalian
Fuzhou
Guangzhou
Hainan Island
Lianyungang
Nantong
Ningbo
Qingdao
Qinhuangdao
Shanghai
Tianjin
Wenzhou
Yantai
Zhanjiang
OPEN ECONOMIC ZONES
Fujian Delta
Yangtze River Delta
Zhujiang Delta
Shanghai Pudong New Area 1990

Table I. Designated Areas for Foreign Investment

Another region that is worth mentioning is the Pudong District of Shanghai. Pudong is an area at the mouth of the Changjiang historically used for agriculture. It has recently been called the "Head of the Dragon," a reference to its gateway position on the Changjiang estuary. By opening this area for development, China is envisioning a prosperous future

for the economy of the entire region. The following table shows the areas designated for foreign investment.

II.F. INDUSTRIES AND BUSINESS DEVELOPMENT FOCUS

China is interested in promoting a number of key industries within these economic zones.

These may be classified into several categories:

- 1. Technology-Intensive Light Industries.** These include pharmaceuticals, fine chemicals, scientific instruments, medical equipment, computer hardware, integrated circuits, fiber optics, laser technology, and other high technology products.¹⁵ These industries provide modern tools for other manufacturing industries as well as generate end products to supply domestic and foreign markets.
- 2. Agricultural Industries.** The focus in this sector is on the development and manufacture of agricultural chemicals and herbicides, as well as agricultural machinery's.
- 3. Technology-Intensive Heavy Industries.** Traditionally, heavy industries have been located both in industrial centers in northeastern and central China as well as around major population centers. Current plans continue to call for location of manufacturing sites for automobiles, airplanes, steel mills, and petroleum refineries in various economic zones, often segregated in special satellite areas.
- 4. Travel-Related Industries.** The influx of tourists and foreign business travelers created a rapidly increasing demand for accommodations and transportation facilities. New constructions of hotels, restaurants, and local transportation infrastructure have taken place in large cities. Shanghai now offers a number of major international hotel franchises.¹⁶

¹⁵ Hua, S.L., *op. cit.*, p.15-20.

¹⁶ For example, Hilton, Sheraton, Nikko, Sofitel, Park, Westin, Holiday Inn, Portman, and Mandarin.

5. **Professionals.** These include attorneys, accountants, tax specialists, charter surveyors, civil engineers, and a variety of consultants in areas of general management, construction management, engineering, and computer aided design.
6. **Infrastructure and Real Estate Development.** Economic growth is constrained by shortages of raw materials, energy, and infrastructure support.¹⁷ Major upgrades in highway systems, railways and bridges, etc. are needed to handle the increasing movement of goods and raw materials between economic centers and suppliers. At present, a substantial portion of urban areas still does not have major utility connections. With a significant influx of "floating" labor force from underdeveloped provinces, housing has become another critical issue. Whereas the coastal regions are experiencing tremendous growth, the western and inland provinces are still lagging behind due to their relative inaccessibility and lower level of industrialization. The need for rapid improvements is well recognized, as infrastructure provides the very foundation upon which the newly planned development must be built.

II.G. PROFILE OF FOREIGN INVESTORS

According to "The China Investment Guide 1986," approximately 1,300 joint ventures were signed in 1985 covering all business sectors.¹⁸ Investors from Hong Kong held an 80% share of these joint ventures. Japan, Western Europe, and the U.S. held fewer than 5% each of the total. It can be expected that the number of joint ventures will continue to increase dramatically in the 1990s. Although precise statistics have been difficult to obtain, the dominant position of the overseas Chinese investors is likely to continue.¹⁹ Well educated and resourceful, the typical overseas Chinese investors share the same culture and language as their host. Shortly after the uncertain period associated with the

¹⁷ Walker and Flanagan, *op. cit.*, p.27.

¹⁸ China International Economic Consultants, Inc. *The China Investment Guide 1986*, (London: Longman, 1986).

¹⁹ Harold Senecker, "The world's wealthiest people." *Forbes*, (July 5, 1993).

Tiananmen Incident in 1989,²⁰ investors from Hong Kong and Taiwan were among the first to resume their investments in China.

China now shares a reciprocal investment relationship with Hong Kong : it is now the biggest investor in the Hong Kong Stock Exchange and the property market.²¹ In 1997, Hong Kong will be returned to China from its colonial rule by Britain, a single entity will be created that embodies additional financial prowess. Meanwhile, the Taiwanese continue to pour capital into China; their investment in the mainland reaching \$9 billion in 1992.²² If the three entities continue to cooperate, China, Hong Kong and Taiwan will become one of the strongest contenders in the world economic arena.

²⁰ In the mid 1980s, gradual economic and political liberalization by the Chinese government encouraged outspoken demands by intellectuals and students for further economic reforms, greater participation in local governments, and improved living conditions in a "democratization" movement. Their increasingly vocal demands and demonstrations were eventually confronted forcefully in June 1989, when troops were sent into Beijing's Tiananmen Square to suppress the demonstrators. The resulting casualty and political upheaval engendered considerable apprehension in and outside China concerning its positions on future reform and economic development.

²¹ "Hong Kong : The shape of things to come.", *The Economist*, (June 12, 1993), p. 42.

²² "Taiwan; Twixt handshake and armlock", *The Economist*, (May 22, 1993), p. 39-40.

III. A HONG KONG-BASED REAL ESTATE DEVELOPMENT COMPANY'S ROLE IN SHANGHAI

Shanghai is an attractive point of entry for foreign real estate developers for several reasons. It represents one of the historical centers of commerce and trade. The city has been officially designated as a Coastal Open City for aggressive development in its metropolitan and surrounding areas. Yet, Shanghai remains relatively open to further development compared with other more saturated centers of development such as Guangzhou, and Shenzhen.

This chapter examines in detail the planning process for two of the first projects undertaken by a major Hong Kong development company--Hang Lung Development Company, Ltd. The work is aimed at illustrating the various aspects of conducting business in a major Chinese city through joint venture relationships. Hang Lung's development strategy is first examined. By way of background, information specific to Shanghai as a real estate development environment will be presented. This is further supported by general information on rules and regulations applicable to joint ventures and real estate developments in Shanghai. Finally, relevant information will be outlined about Hang Lung's approaches to handling two of its major projects located in Shanghai: the Siping Lu Centre and the Xujiahui project.

III.A. HANG LUNG DEVELOPMENT CO. LTD

Hang Lung Development Company Ltd (Hang Lung), a publicly owned company traded on the Hong Kong Stock Exchange, is one of the leading real estate development and investment companies in Hong Kong. It is responsible for many of Hong Kong's notable residential and commercial developments. Hang Lung has a current market capitalization of US\$2.01 billion, making it the fourth largest property developer in Hong Kong, after

Sun Hung Kai Properties (US\$9.6 billion), Cheung Kong (US\$7.6 billion) and Henderson Land (US\$5.03 billion).²³

Hang Lung's investment property interests are held by its publicly listed subsidiary, Amoy Properties Ltd. Amoy's portfolio comprises substantial commercial, industrial, and residential properties, strategically located in popular districts and along major transportation routes. Grand Hotel Holding Ltd., a third publicly listed subsidiary of Hang Lung, owns and operates hotels.²⁴

III.A.1. Investment Strategy

As 1997 approaches, Hong Kong is becoming increasingly integrated with China. For a Hong Kong development company that has the vision to flourish and expand after 1997, China becomes an important potential market. Before Hang Lung made any investment in China, it had to satisfy itself relative to a few key questions. What are the risks? Which cities should it invest in? What is the optimal project size? How would the projects be run? Who would be managing them?

In August 1992, after extensive market research, Hang Lung started its first investment in China in the form of a residential/commercial development in Shanghai. The chairman, Ronnie C. Chan, described the company's investment strategy in its 1991-1992 Annual Report:

"The decision to enter the China market is a result of much careful and systematic research. Recognizing that Hong Kong and China are economically integrated and increasingly so, it is imperative that we comprehend and be correctly informed about this country. I began my

²³ M. Tong, *Merrill Lynch Capital Markets: Hang Lung Development-Company Report*, State of New York, May 21, 1993.

²⁴ *Hang Lung Development Company Limited Annual Report 1992-1993*.

monthly visits to China over a year ago with the simple intention to assess and understand the recent developments there. My approach may be relatively unconventional. I contacted first the people from the local level i.e. district officials, and systematically worked my way up the hierarchy. It is apparent that the economic openness initiated in the late 1970's is an irreversible and pervasive phenomenon. Further research and visits by my colleagues confirmed the same, thus giving us the confidence to invest our first dollar in China.

While it would be naive to expect consistently smooth sailing, it is nevertheless quite clear in which direction China is heading. As long as the country's "one central focus" of economic development remains unchanged, the future of China is bright. As real estate prices always track economic growth and prices in China are still at rather low levels, there should be plenty of opportunities for our industry in the country....We must adopt to the local environment because the risks are many and some are foreign to us in Hong Kong. Recognizing these ..., we have adopted a cautious strategy. With few exceptions, we will concentrate on the best locations in major population centres. Indeed our first project is in Shanghai."²⁵

Political stability is prerequisite to long-term economic growth. The ability of a foreign company to capture and realize potential investment opportunities depends on its ability to track, analyze, and react to changes in China's political climate and any resultant shifts in development policy. It is fair to speculate that political consideration is high on Hang Lung's list of priorities, and it is balancing political risk with potential investment opportunities.

Another factor that supports the decision to invest in China was the timing. While the political power remains centralized in Beijing, the economy is relatively decentralized in terms of the authority regional governments exercise. China's move toward a more pro-business attitude is exemplified by a recent shift in land-use policy. In the case of Shanghai, before 1990, private investors had only been able to negotiate land-use rights

²⁵ *Hang Lung Development Company Limited Annual Report 1991-1992*, p. 10.

terms varying between 10 and 22 years. (See Table VIII in Appendix A) In 1990, the National Legislature revised the land-use lease terms as follows:^{26,27}

Commercial:	40 years
Residential:	70 years
Industrial:	50 years
Social:	50 years
Mixed-Use	50 years.

Further evidence of a fundamental political change can be seen in recent national events. In April 1993, the Central Government amended the constitution by adding that China would maintain the open reform policy, and practice socialist style market economy.²⁸ In May 1993, price controls on goods and services were lifted in Beijing. Interestingly, citizens did not react with a last-minute buying frenzy typically preceding such announcements.²⁹ This response shows high level of confidence in the economy. On the international front, China is campaigning to host the Olympics in Beijing in 2000,³⁰ and is negotiating to participate in the General Agreement on Tariffs & Trade (GATT),³¹ gestures that signals an openness and willingness to play an active role in the world economy. The official changes in attitude have also fostered a pro-business sentiment in a population that is eager, if not yet well-prepared, to participate actively in rapid economic growth. Chan light-heartedly described today's Chinese people as "capitalists," referring to them as "1.158 billion entrepreneurs."

²⁶ Anthony Walker, *Land, Property and Construction in the People's Republic of China* (Hong Kong: Hong Kong University Press, 1991), p.50

²⁷ Tutian Cai and Changhao Gu, eds, *Shanghai: Manual of Real Estate Investment and Management*, (Shanghai: Shanghai People's Press, 1993), p.169.

²⁸ Kwanru Xi, "Adding Market Economy to the Chinese Constitution," *Ta-Kung-Pao*, April 1, 1993, p. 1.

²⁹ "Prices Decontrolled in Beijing," *Ta-Kung-Pao*, May 11, 1993, p.1.

³⁰ "China belongs to me," *The Economist*, (May 29, 1993), p.13.

³¹ "China's yuan: Sell," *The Economist*, (March 20, 1993), p.86

III.A.2. Shanghai

To select a city for its investments, Hang Lung looked for a local economy resembling that of Hong Kong,³² i.e., a city that has geographical constraints, densely populated, and fast-growing. Similar to Hong Kong, Shanghai is densely populated. (See Section V.A.2.) Its large population of around 13 million represents a huge consumer base and a labor force that is among the most highly skilled in the country. (See Section V.A.3.) As Shanghai is one of the original fourteen Coastal Cities designated for foreign economical investment, its policy of growth is directly endorsed by the central government. With the addition of the Shanghai Pudong New Area in 1990 to the list of special economic zones in China, the development opportunity in metropolitan Shanghai was further expanded. Appendix A provides a detail account and statistics of the current economic development and real estate market in Shanghai.

Compared to Beijing and Guangdong, less construction has taken place in Shanghai to-date. Total new commercial and residential construction in 1990 amounted to 2.25 billion yuan (US\$392 million) in Beijing; 3.98 billion yuan (US\$693 million) in Guangdong, and 0.68 billion yuan (US\$118 million) in Shanghai.³³ The lower level of construction activities in Shanghai results in lower costs for land and material, hence lower capital investment costs to investors. Chan used the example of comparing the annual land-use fees of three locations: in Shanghai, the annual land-use fee is US\$1.00/sq. meter, in Guangzhou it is US\$1.40, and in Beijing US\$1.80. Hang Lung prefers to enter a new market before it is saturated with other developments. This and other factors contributed to the selection of Shanghai as the target of Hang Lung's first investment in China.

³² From a speech given by Ronnie C. Chan, at the MIT Center for Real Estate Members Meeting, in June 1993, in Cambridge.

³³ Yuanrey Zhang *et al*, *Directory of Real Estate Development in China*, (Heilongjiang: Heilongjiang science and Technology Press, 1991), p.747

III.A.2.a) Real Estate Market in Shanghai

The real estate market in Shanghai is flourishing. In 1987, the city adopted new progressive regulations to divide the real estate market into domestic and foreign categories. The latter category was established to encourage foreign enterprises to invest in real estate by legalizing their buying, selling, assigning and mortgaging of properties in Shanghai.

Section V.C., Real Estate Market in Shanghai, of Appendix A provides supporting data and description of the market in detail. Briefly, total real estate investment reached US\$452 million in 1991, the highest level since 1949. Among different types of development, over 85% were for industrial real estate. The Shanghai government has undertaken some major public work projects to modernize the city in the past few years. These included a new underground railroad system, a new beltway, airport extensions, and new power plants. These new amenities make Shanghai more attractive for foreign business enterprises, which in turn further increases the demand for new real estate.

The residential real estate market has three pricing levels. In descending order, these are 1) the market price, intended for foreign investments; 2) the overseas Chinese category, reserved for them and their relatives; and 3) the local citizen level for PRC citizens and agencies. (See Section V.C.2.).

Residential, commercial office, and hotel developments in Shanghai all increased during 1991. Around 60,000 square feet of residential real estate were developed in the market price category. The residential portion of both of Hang Lung's projects will be in the market price category. As of 1991, the Shanghai real estate office market had sufficient supply of space in the upper price range (\$25/sq.ft or more), but had a greater demand at

the lower price range levels (\$10 to \$20/sq. ft. range). Hotel occupancy rate was 60%, little changed from previous years. See Sections V.C.2. to 4.

Inflation has been problematic in China. 1992's inflation in China was 5.4%, and is likely to run into double digits this year.³⁴ The issue is even more acute in the cost of construction materials. Coupled with the devaluation of the yuan, increasing prices makes construction cost estimation difficult. Table VI in Appendix A shows average construction cost for new commercial construction as of 1991. It is noteworthy that between 1990 and 1991, construction cost per square meter for factories had gone up 54%; and for office buildings had increased 85%.³⁵ Both types of buildings are commonly used by foreign investors.

III.A.3. Proposed Budget

The strategy that Hang Lung adopted is to develop only two or three choice projects at the best possible locations in a targeted city. The total investment in China accounts for less than 10% of Hung Lung's assets,³⁶ which amounted to US\$3.136 billion in the middle of 1992. (See Appendix B). As of this writing, Hang Lung has two projects in progress in Shanghai. These are the Siping Lu Residential and Retail Centre and the Xujiahui Centre. Presently both projects are at the schematic design stage. A letter of intent has been signed for a third project, the Nanjing Xi Lu Centre.

³⁴ "China's yuan: Sell", *The Economist*, (March 20, 1993), p. 86-88.

³⁵ Tan, '92, *Shanghai Real Estate Market*, *op. cit.*, p. 23.

³⁶ "Xujiahui: US \$500 million Investment Plan By Hang Lung, Henderson, and Hysan", *Sing-Dao-Daily*, February 20, 1993.

III.A.4. Organization

III.A.4.a) Hang Lung China Division

In January 1993, Hang Lung formed a China Division in Hong Kong to handle all of its projects in the People's Republic of China. This division is headed by Senior Manager, Charlie Lin, who was educated in Taiwan and the U.S. Working with him are two managers, Roy Ho, an experienced property manager from Hong Kong, and Gavin Lu, a registered architect from Singapore, who received his college education in Australia. All three are Chinese, speak fluent putonghua, that is Mandarin, and are computer-literate--an as-yet uncommon skill among senior real estate development managers in Hong Kong and China. All three managers travel to Shanghai averaging about once every two weeks.

The staffing within Hang Lung's China Division illustrates the importance of effective personal-level communication in conducting business in China. At this time, even in the relatively cosmopolitan Shanghai, sharing a common language and having a thorough understanding of the culture is prerequisite to establishing trust and avoiding miscommunication.

III.A.4.b) Hang Lung Shanghai Properties Ltd.

Hang Lung has also formed and registered a wholly-owned company in Shanghai, the Hang Lung Shanghai Properties Ltd. Charlie Lin is also directly in charge of this group. The company serves as the base of operation connecting the Hong Kong headquarters to the design consultants, suppliers, contractors and sub-contractors located in Shanghai; and establishes professional relationships at all levels to work in a climate of confidence and respect. Working with Lin is Daniel Yang, Senior Vice Manager of Hang Lung Shanghai. Yang is a native of Shanghai, has experience in real estate development, and was hired to

assist Lin to work with the local contacts. Lin and Yang are continuing to build a local staff. The ones they have recruited are college educated, competent and computer literate.

Hang Lung Shanghai is located in a new six-story office building in the Luwan District of Shanghai. The office occupies about 240 square meters (2583 sq.ft.), at an annual rental rate of US\$12 per square foot. Information transfer between Hong Kong and the Shanghai office is by computers and facsimile machines. Cellular telephones are used extensively for local communication, and to some extent with Hong Kong. These types of communication technology were not available a few years ago; however, computer hardware and software still cost more in Shanghai than in Hong Kong.

III.B. RULES AND REGULATIONS SPECIFIC TO JOINT VENTURE REAL ESTATE DEVELOPMENT

III.B.1. The Property Market In China

Private ownership of real property does not exist in China. All land is owned by the government and is not for sale. After the establishment of the open door policy, the Chinese government recognized the value of the right to use land, especially by foreign invested joint venture enterprises. As an alternative to land sales, the government established a property market in which land-use rights may be traded as a commodity. The primary instrument used in transacting development projects or improvements on specific properties is referred to as a *land-use right contract*.³⁷

Three methods are used by the government in selling the land-use rights:

- Negotiation. An interested party may purchase the right by negotiating a lump sum paid to the government;

³⁷ Walker, *Land, Property and Construction*, p.36.

- Bidding. The request to bid contains site and development constraints with which the bidders must comply. In response, the bid must include outline compliance solutions;³⁸
- Auction. This typically results in the highest cost to the developers.

Most developers prefer to acquire land-use rights by negotiation. However, the government specifies the method of sale employed in individual cases.

Parallel to this commodity system, there is an annual land-use fee system. The development enterprises are charged an annual fee for the usage of the land. The fee is based on location and permitted use by the planning commission, and varies from city to city. "This system is inconsistent and needs improvement."³⁹

III.B.2. The Land Use Right Contract

A typical Shanghai land-use right contract may include some or all of the following elements:⁴⁰

1. Description of the property,
2. Land use right period in years,
3. Annual tax,
4. Site area,
5. Conditions of development (including permitted use; site coverage, plot ratio, total permitted floor area, height limit, greenery as percentage of the site, parking requirement, etc.)
6. Municipal services to the site,
7. Total price of the land use right, and currency use,

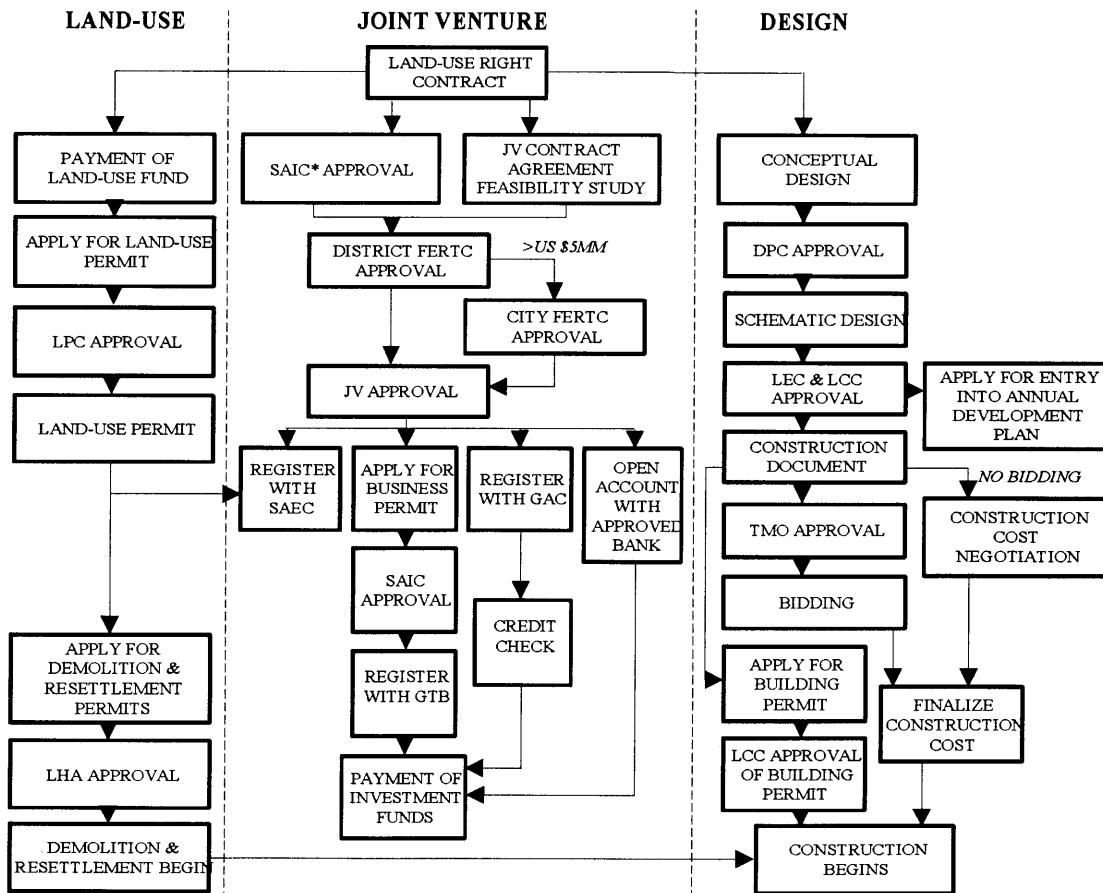
³⁸ *Ibid.*, p.44.

³⁹ *Ibid.*, p.37.

⁴⁰ Yutian Cai and Changhao Gu, eds, *Shanghai: Manual of Real Estate Investment and Management*, (Shanghai: Shanghai Peolpe's Press, 1993), p. 96.

8. Method and terms of payment,
9. Assigning, renting and mortgaging of land use rights,
10. Fees for the contract,
11. Repossession at the end of the lease term.

The above list is representative but not exhaustive. Items (2) and (3) are code issues. The length of the land use right period depends on the permitted use of the site. (See Section III.A.1.). Item (5) outlines requirements dictated by the planning department. Item (9):



SOURCE: HANG LUNG DEVELOPMENT COMPANY, LTD.

* SEE SECTION III.B.3 FOR KEY TO ABBREVIATIONS

Figure 2. Joint Venture Real Estate Development Process

Under certain constraints, the contract may be assignable, rentable or mortgagable. Item (11): At the end of the lease term, the government will repossess the land and all the improvements on it. The user will surrender all his land use rights, and all site improvements unconditionally. In the case that the user would like to continue usage of the site, he must reapply a new land-use right contract before the expiration of the original term. However, it is a common expectation that the land-use right user would be able to renegotiate a new lease prior to termination.

For further details, one should refer to the Chinese versions of these documents.⁴¹ Since the focus of the present study is on the planning process of real estate development projects, only issues affecting that process will be discussed.

III.B.3. The Governmental Agencies And The Approval Process

There are many governmental agencies directly involved in the approval of foreign invested joint ventures and real estate development projects. The following is a list of agencies directly involved with the approval process. Information is compiled from that provided by Hang Lung and from Walker and Flanagan's *China: Building for Joint Ventures*.⁴² Refer to The roles of various agencies in the approval process of the foreign invested joint venture and the real estate development project is shown in Figure 2.

- FERTC Foreign Economic Relations and Trade Commission

This agency has offices on the district and city level. They examine and approve joint venture contracts.

- DPC District Planning Commission

This agency examines and approves the project proposal report.

⁴¹ *Ibid.*, p.96-129 and p.167-222.

⁴² Walker and Flanagan, *op.cit.*, p.71.

- **GAC General Administration of Customs**
It supervises import and export activities. It checks the credit worthiness of the joint venture enterprises.
- **GTB General Tax Bureau**
It works under the Ministry of Finance, manages State tax revenues and handles joint venture tax issues.
- **LCC Local Construction Commission**
The function of this agency is similar to that of building departments in the U.S. It examines and approves the design of the project, construction documents, and issues building permits.
- **LEC Local Economic Commission**
It works with the LCC in the approval of the design.
- **LHA Local Housing Authority**
It is responsible for the approval of the demolition of existing site structures.
- **LPC Local Planning Bureau**
It approves the application of the land use certificate.
- **SAEC State Administration of Exchange Controls**
Its approval is required before joint ventures and foreign owned enterprises can set up an account with foreign banks.
- **SAIC State Administration of Industry and Commerce**
It approves feasibility reports and registration of joint venture contract.
- **TMO Tender Management Office**
It approves bidding documents.

In his book *Land, Property and Construction in PRC*,⁴³ Anthony Walker called the administration system "formidable for foreign investors." However, there are indications that organization of the process is improving and there are more workable solutions. In Hainan, for example, "the Ministry of Foreign Economic Relation and Trade (MOFRET) co-ordinates all the agencies in the process," thereby providing some structure for present and potential investors and developers.

In the U.S., the architects normally assist the clients in the project approval process, it is also true to some extent in China. Both the design teams and the PRC joint venture partners help in spear-heading the process. The role of the design institutes (described below) is similar to that of the U.S. architects.

III.B.3.a) The Design Institutes

The design institutes are public institutes with functions similar to the U.S. architectural design offices. However, the design institutes provide both architectural and engineering services; whereas the US architectural offices handle mainly architectural, and sub-contract the other services to outside engineering consultants. Within these institutes, there are registered architects and engineers. It is a normal practice for the construction commission to recommend and allocate an institute to work with the joint venture company.

Similar to western countries, all construction documents in China are mandatory to be signed and stamped by architects and engineers registered in China. A joint venture company has the choice of hiring a PRC design institute, or employing a foreign design company to collaborate with the local PRC design institute.

⁴³ Walker, *op. cit.*, p.81.

As stated in Walker and Flanagan's *Building for Joint Ventures*,

"Design institutes lie within the hierarchy of committees established to initiate and control development and construction within each municipality, province and economic zone in which they are located. For, example, there are 40 design institutes in Shanghai. The smallest has about 100 employees and the two largest are the Shanghai Municipal Institute of Civil Architectural Design and the East China Design Institute. Each has approximately 900 professional and technical staff.....they are large design organizations.

The scope and expertise of design institutes vary considerably. They are classified in four classes from A to D according to the type, size and location of the work they are allowed to undertake.....Because of the importance of joint venture projects in terms of foreign investment and knowledge transfer, the design tends to be allocated to the higher category design institutes.

The strength of the design lies in structural design. The design institutes' staff are academically competent but, at present generally lack practical experience in technologically advanced construction, mechanical and electrical services..."⁴⁴

III.B.3.b) The Phases Of Design

From the information provided by Hang Lung, generally there are three phases of architectural design in a development project: conceptual, schematic, and construction documentation.

In the conceptual design phase, information required are location map, site plans, conceptual floor plans, conceptual building sections, and general description of the project. They represent the overall concept of the proposal. This phase is similar to the pre-design, conceptual proposal stage in U.S. development projects.

⁴⁴ Walker and Flanagan, *Building for Joint Venture*, p. 82-83.

The second phase, the schematic design is roughly equivalent to the design development stage in the U.S. However, requirements are more elaborate, it includes more information than the typical U.S. schematic design drawings, with heavy emphasis on the constructability of the project.

Information that was in the schematic design package of Hang Lung's first project, the Siping Lu Centre, included project description, architectural and engineering design standards, outline specifications showing the general building materials and finishes, outline specification from the structural, mechanical, electrical, and plumbing engineers, trade-by-trade detailed construction cost estimates, architectural drawings, structural, electrical, communication, fire safety, heating, ventilation, and air-conditioning drawings. The emphasis is on the functionality of the project, rather than on the architectural design.

The third phase is on construction documentation. This is equivalent to the U.S. working drawing stage. Drawings are prepared for bidding and construction. The level of detail required is more extensive than that normally expected in the west. In most instances, working drawings are down to the level of detailed shop drawings. The reason is the PRC specialist trade contractors do not produce shop drawings, that is the responsibility of the design institutes. Therefore, all the drawings are very detailed, and labelled in Chinese. It is not unusual to see a medium sized project with several thousand drawings.⁴⁵

As can be seen from the above list and Figure 2, the project approval process is rather elaborate and bureaucratic. Without the PRC partner, approval would be difficult for a foreign investor. Even with the assistance from a PRC partner, it remains a time consuming process.

⁴⁵ Walker and Flanagan, *Building for Joint Ventures*, p.83.

From an architectural point of view, the system is relatively deficient in aesthetic design control, both in terms of building design and urban design. This is curious in view of the numerous other agencies present in the system charged with reviewing different aspects of the project, but may be due in part to the rapid growth in demand of developed space following decades of relative stagnation. The pressure to meet that need might have led to certain compromises in quality of design. The District Planning Commission, as the primary agency that controls aesthetic design directions, reviews projects mainly at the schematic stage to check for compliance to planning issues. With the enormous amount of construction going on in China, it is important to promote high aesthetic architectural design standards. Not only does a good design appeal to the users, it helps preserve the long-term value of buildings and their environment. In numerous other locations in the world, examples abound in which a lack of attention and planning to organized development standards have led to uneven quality of appearance and utility. Ultimately, the success of the built environment reflects its people and its culture, and would be used and appreciated by generations to come.

III.C. THE PLANNING PROCESS OF DEVELOPMENT PROJECTS

In this section, two case studies are presented to illustrate the detailed process undertaken by Hang Lung in planning and managing its development projects in China.

III.C.1. Project 1: The Siping Lu Centre

This was Hang Lung's first investment in China. Hang Lung was introduced to the availability of this property for development by Yam Wong, Director and Manager of The World Land & Investment Co., Ltd. of Hong Kong. Previously a banker from the Bank of

China of Hong Kong, Wong has a network of contacts and extensive experience in dealing with government agencies in China--an important asset in the current environment.

III.C.1.a) Project Description

Siping Lu is a new mixed-use project located on its namesake thoroughfare--Siping Lu--in the Hongkou District of Shanghai. It consists of two 22-story high-rise residential towers, which are set on a common 2-story retail platform complete with underground parking. Total gross area will be 42,300 square meters (455,313 sq.ft.), of which 85% is designated as residential space (387,016 sq.ft.), and 15% as retail space (68,297 sq.ft.). The lot size and the permitted use were predetermined by the planning department and other city

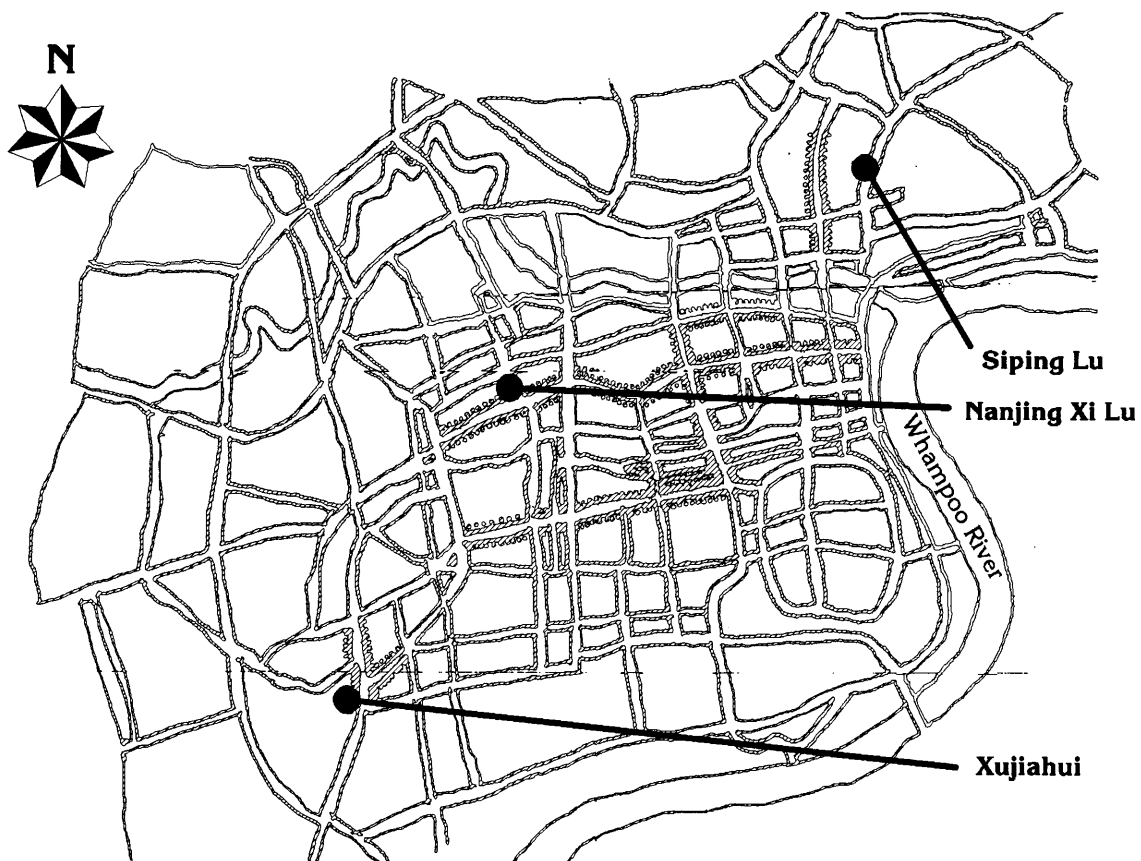


Figure 3. Location of Hang Lung's Development Projects in Shanghai



Figure 4. Perspective View of the Main Buildings of the Siping Lu Project

officials. Figure 3 shows the site location of this project; Figure 4 is a perspective view of the main buildings.

III.C.1.b) The Land Use Right Contract

Hang Lung began its negotiations with the district and housing officials in charge of this project in the spring of 1992. It took approximately four months for the parties to reach agreement on the terms of the land-use right contract.

During the negotiations, Hang Lung did not have a partner in China with whom to form the equity joint venture. However, both the city and the district were interested in participating indirectly as equity partners. As a means of separating separate politics from business, the business interest of the city of Shanghai and that of the district were represented by two separate corporations. In an arrangement reached among the three parties, each would invest in both the land lease and the joint venture. Interestingly, the Chinese officials were at once both the direct sellers and the indirect buyers of the land-use right contract--a situation that raises the issue of potential conflicts of interest, but potentially beneficial to Hang Lung.

Hang Lung was investing through one of its subsidiaries. The equity apportionment for the three parties in an agreement dated August 1992 was:

Country First Enterprises Ltd. (Hang Lung)	70%
Shanghai Xincheng Housing Enterprise Co. (City of Shanghai)	25%
Shanghai Si Ping Developing & Leasing Corporation (District)	5%.

Hang Lung and its partners were able to negotiate a 70-year land-use right term. The planning requirements from the Planning Commission for Siping Lu were:

Site area:	9,400 sq. meters (101,180 sq.ft.)
Permitted use:	Mixed-use/Residential and Retail
Plot ratio (or FAR): ⁴⁶	4.5
Max. site coverage:	60%
Height limit:	100 meter (328 ft.)
Minimum greenery:	20% of total site

⁴⁶ FAR: Floor-Area Ratio, equivalent to Plot Ratio

With a plot ratio of 4.5, the maximum buildable area is: 9,400 sq.m.*4.5 = 42,300 square meters (455,313 sq.ft.).

Regarding municipal services to the site, the normal practice is for the municipality to provide a cleared site and three services to the boundary of the site: water supply, electrical power, and road connections. However, local authorities also recognized that modern buildings require additional basic services. More recently, therefore, developers have been able to negotiate seven services and a cleared site, (the additional services being gas supply, soil water drainage, sewage and communication hookups). Hang Lung was able to negotiate all seven municipal services and a cleared site for both the Siping Lu project and Xujiahui project (see next section).

Typically included in the price of the land use right are the costs of resettlement of all the existing tenants and residents, and the demolition of existing site structures. For Siping Lu, resettlement and demolition costs represented 85% of the total land lease cost.

Site area	9,400 sq. meters (101,180 sq.ft.)	
Land cost:	US\$ 2,664,900	15%
Demolition and relocation cost:	US\$15,101,100	85%
Total land-use right cost:	<u>US\$17,766,000</u>	100%
Land cost per square meter	<u>US\$1,890</u>	
Land cost per sq.ft.	<u>US\$176</u>	
Allowable buildable area (FAR sq.ft.)	42,300 sq. meters (455,313 sq. ft.)	
Land cost per sq.m.of buildable area:	<u>US\$420</u>	
Land cost per FAR sq.ft.:	<u>US\$39</u>	

Estimated construction cost: US\$30.5 million⁴⁷

Estimated construction cost/FAR sq.ft. US\$68

Total land & construction cost/FAR sq.ft. US\$106

Since the contract already includes the cost of demolition, the municipality is able to deliver a cleared site to the developer without a second time charge.

After securing the land-use right contract, Hang Lung and its partners began organizing the project. First of all, they had to form an equity joint venture. At the same time, they had to hire consultants to work on the project feasibility study for approval by the district officials. Hang Lung estimated that this pre-design organizational phase would take about six months.

III.C.1.c) The Equity Joint Venture: Heng Cheng

The three partners formed an equity joint venture--essentially a limited-liability corporation--to manage and invest in the development project. The joint venture was called the Shanghai Heng Cheng Real Estate Development Co. Ltd. (Heng Cheng). Having PRC partners in a joint venture helped expedite the approval process, and guided the foreign investors through the complex administration system.

Negotiations of the Siping Lu joint venture contract took five months. Discussions centered on the decision-making process and the assignment of responsibilities. One area of Hang Lung's expertise was in the development of large scale residential projects in Hong Kong, while the PRC partners were more accustomed to smaller scale and less complex projects. However, Hang Lung lacked the experience of working in China, and

⁴⁷ Information from Hang Lung: estimated cost is US\$500/sq.m. of gross construction floor area (GCFA), GCFA=61,000 sq.m..

this was the area that the PRC partners played an important role. The partners complemented each other's skills, and they all had much to gain from the collaboration.

The policy-making body of the joint venture corporation, Heng Cheng, is the board of directors. The board consists of six directors from Hung Lung and three from PRC. Its responsibility is to oversee strategic directions and to review financial affairs of Heng Cheng. Reporting to the board is the General Manager, who handles the operations of Heng Cheng. In this case, the General Manager is from the PRC, and is appointed by the PRC partners. He is the principal liaison between Hang Lung and the joint venture. This reporting structure within the joint venture is also shown in Figure 5.

The Shanghai Xincheng Housing Enterprise Co. (Xincheng), represents the city's interest. Its function within the joint venture was to assist Hang Lung in successfully developing the Siping Lu project on Chinese soil. Xincheng was responsible for setting up and staffing the joint venture corporation. In fact, some of the staff of Heng Cheng were transfers from Xincheng. The district officials, through their business arm of Shanghai Si Ping Developing and Leasing Corporation, were not directly involved with the management of Heng Cheng. This corporation acted more like a limited partner in the joint venture.

Besides overseeing the development and controlling the financial aspects of the project, Hang Lung was directly involved with the design. It made ultimate decision on the hiring of design consultants, and on approving all drawings and design.

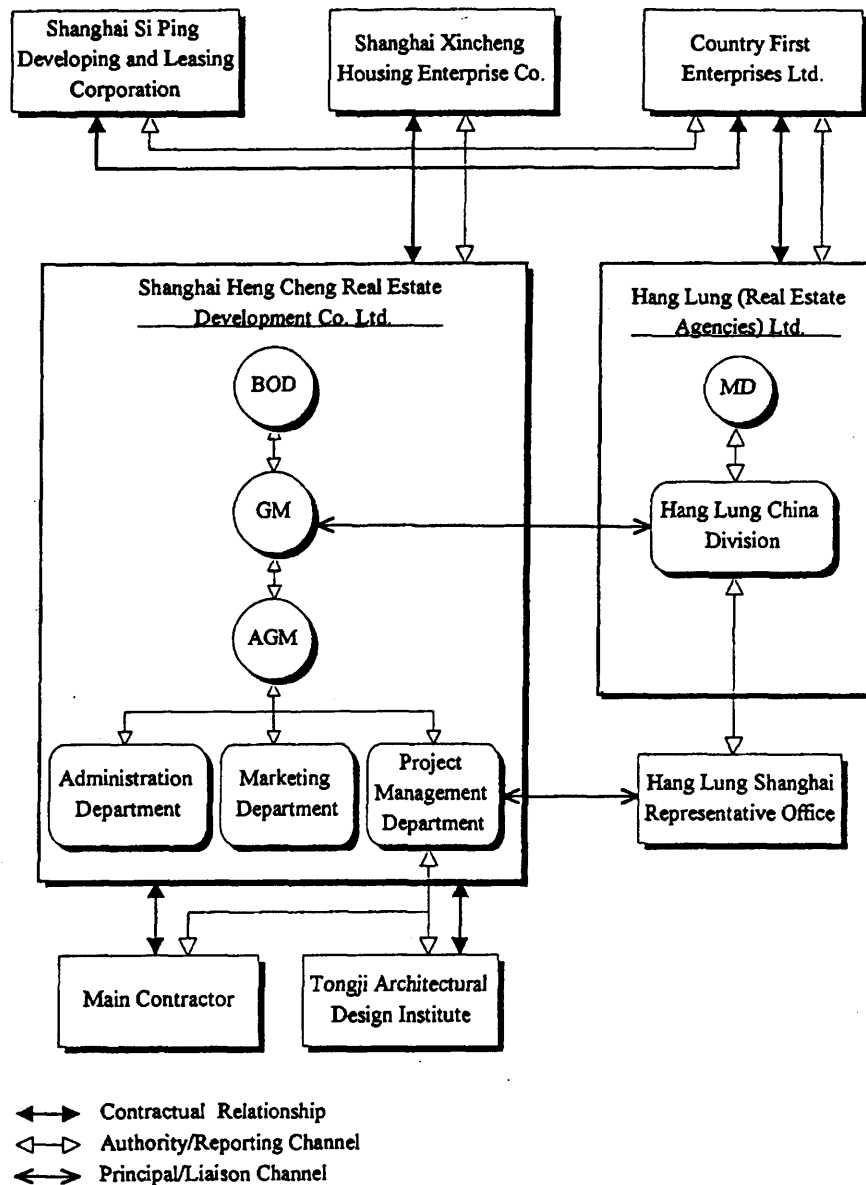


Figure 5 Organizational Diagram of the Siping Lu Project

There were three departments within Heng Cheng: project management, marketing, and administration. Together, they were responsible for:

- Orchestrating the project approval process.
- Applications of all necessary city and district permits.
- Provide the appropriate level of contacts in other government agencies.
- Provide information on local consultants, trades, and building materials.

- Representing the owners during the construction phase.
- Assisting Hang Lung in marketing.
- Managing the operation of the joint venture.
- Keeping Hang Lung informed of all project activities.

III.C.1.d) Hang Lung's Project Financing

Hang Lung was developing Siping Lu entirely on equity financing. Banks in Hong Kong would only finance projects up to 70% of the construction cost. According to Lin, using construction projects in China as collateral for loans in Hong Kong was not feasible; and money supply in China was so tight that loans were virtually impossible to obtain. As indicated in Hang Lung's 1992-93 Annual Report,⁴⁸ only HK\$1.6 billion (US\$205 million)⁴⁹ of the company's HK\$24.4 billion (US\$3.128 billion) asset was from bank loans. Since the company was not highly leveraged, it had a strong cash position to finance the project with its own equity. Both the residential and the retail portions of the Siping Lu project are developed for sale. Hang Lung is not retaining this project for long-term investment.

III.C.1.e) The Design Team

Tonji University Design Institute (Tonji) was recommended by the officials to Hang Lung as the design consultant to the project. If Tonji were to be hired, Siping Lu would have been the largest project it ever designed. Not knowing Tonji's design capabilities, but intent on beginning the project immediately, Hang Lung decided to hire an architectural firm, Rocco Design Partners of Hong Kong.(Rocco), to work on the conceptual design, while it continued to negotiate with Tonji over the remaining design services.

⁴⁸ *Hang Lung Development Company, Limited Annual Report 1991-1992*, p.34.

⁴⁹ The exchange rate used is 7.8 to a dollar.

Rocco Design Partners Of Hong Kong

Over the years, Hang Lung has developed successful working relationship with a number of large architectural firms in Hong Kong; Rocco is one of them. Rocco could provide good architectural design services, but up to this point had little experience working in China. Recognizing that a PRC design institute would be more familiar with the project approval process in China, and after being unable to agree on a design fee with Rocco, Hang Lung decided to award the remaining design contract to Tonji. By the time Tonji took over the project, Rocco had successfully finished the conceptual design, and Tonji used Rocco's design for the schematic design package.

Tonji University Design Institute

Among the benefits for employing PRC design institutes is that, given their close contact with various governmental agencies, they understand the design and planning processes intimately. They are familiar with building, planning, and engineering regulations, and are up to date on amendments and notices. They are informed about local trades, construction practices, and the availability of building materials. Moreover, they provide full architectural and engineering services for the developers. Tonji offered all of these advantages. However, their lack of experience in large-scale high-rise projects remained an issue.

Specifically, according to Hang Lung, although Tonji was strong in structural design, it was less knowledgeable in engineering high-rise heating, ventilation, and air-conditioning systems. This is understandable as the demand for such services has only expanded with the recent economic boom. This issue should be resolved, however, after the design institute successfully completes a number of large scale contemporary high-rise projects. Unlike most large architectural firms in Hong Kong,, the U.S., and even its counterparts in

China, Tonji did not utilize a CAD (computer aided design) system that can significantly improve speed and accuracy of the design process. Tonji was reluctant to start new drawings until design questions were completely resolved, leading to much time spent on meetings while producing few drawings. As a result, Hang Lung had to spend more time and effort with Tonji than with other architects it was familiar with. Finally, there was a definite lack of understanding of designing buildings that would be marketable. As Lu put it, it was "extremely difficult to come up with a building design that we want." Designing the project was a learning experience for both parties.

While negotiating the design fee with Tonji, Hang Lung found the original proposal from Tonji unsatisfactory. Tonji then agreed to lower its fee in return for a two-week educational tour in Hong Kong for a group of its engineers and architects. In the final contract between Hang Lung and Tonji, the design institute's fee was based on percentage of construction cost with a maximum amount not to exceed. On top of that, lump sum travel expenses were specified in the contract, as was the actual number of visitors. According to Hang Lung, it is not an unusual practice for PRC businessmen to request overseas travel.

The architectural practice at Tonji was notably different from that in Hong Kong or the U.S. One example of this was that the design team was headed by a structural engineer rather than an architect, which would have been the normal practice. Hang Lung asked to have that changed. This unusual practice strongly biased the design direction of Tonji toward one that emphasizes structural design over aesthetic design.

Given its experience dealing with Tonji, Hang Lung decided that for its next project, which is seven times larger than Siping Lu, it will hire architects and mechanical engineers

from Hong Kong. The design team from Hong Kong will collaborate with a PRC design institute that would be assigned a minor consultant role.

III.C.1.f) The Project Schedule

At the time of this writing, Tonji has finished the schematic design drawings. Hang Lung has yet to contract a construction company. It needs to decide whether that company should be Hong Kong-based or China-based. Part of the decision relates to the experience of a given PRC construction company on projects of this scope. It might be an interesting area for further study to follow some of these projects, to trace the construction practice, and to see if Hang Lung has achieved its investment goals.

Once a construction company has been selected, the project will proceed on a fast track schedule to save time and money. In August 1994, Hang Lung plans to start the sales of residential and retail units. The target completion date is in the late summer of 1995.

III.C.2. Project 2: Xujiahui

In February 1993, when Chan signed the land-use right contract for the Xujiahui Centre in Shanghai, it made headline news in Hong Kong. Other developers looked on with great admiration as this newcomer to the China real estate development market was able to secure the prime site for the largest development project in this key city. A site of this quality attracted many potential investors. Approximately forty development companies showed interest in the project. Hang Lung was eventually chosen based on its successful experience in the development of above-subway complexes, and large-scale retail projects in Hong Kong.⁵⁰

⁵⁰ "Hang Lung Secured a Prime Site in Shanghai," *Min Hui Daily*, February 20, 1993.

The site for the Xujiahui Centre is situated in the Xuhui District of Shanghai. It is located above the new Xujiahui station in the Shanghai underground railway network system. One edge of the site abuts Huashan Lu, a major thoroughfare in the Xuhui District. The area around the new station has recently been renovated. New hotels, office buildings and department stores have been constructed, making this area a major commercial and retail center of the Xuhui District. Most of the residential areas in the Xuhui District are European in style located along tree-lined avenues. Xuhui District was in the original French Settlement. (See Figure 3 for site location.)

III.C.2.a) Project Description

The Xujiahui Centre is a new residential, retail and office complex. The development is divided into a residential section, and a retail and office section. Under the 1990 National Legislature on land-use reform, land-use term for residential projects is 70 years, while that for mixed-use projects is 50 years.⁵¹ By separating the uses, Hang Lung is able to take advantage of the longer land-use right period for the residential portion of the development, thereby capturing the full potential of the site. Figures 6 and 7 show the site plan and perspective for the Xujiahui project, respectively.

⁵¹ Cai and Gu, *op. cit.*, p. 169.

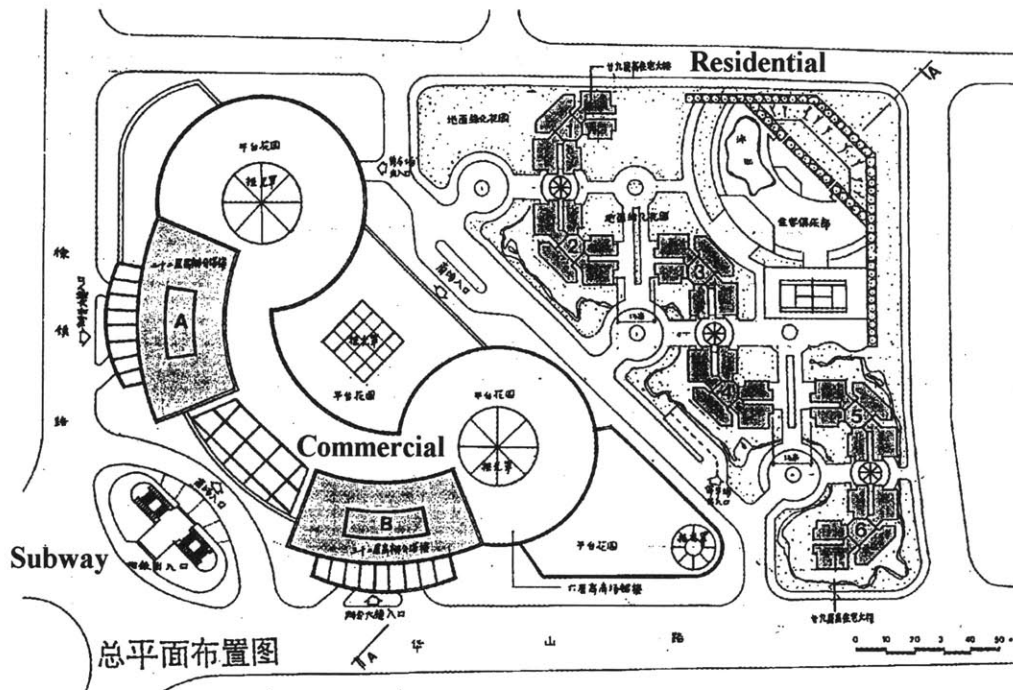


Figure 6. Site Plan for the Xujianghai Project.

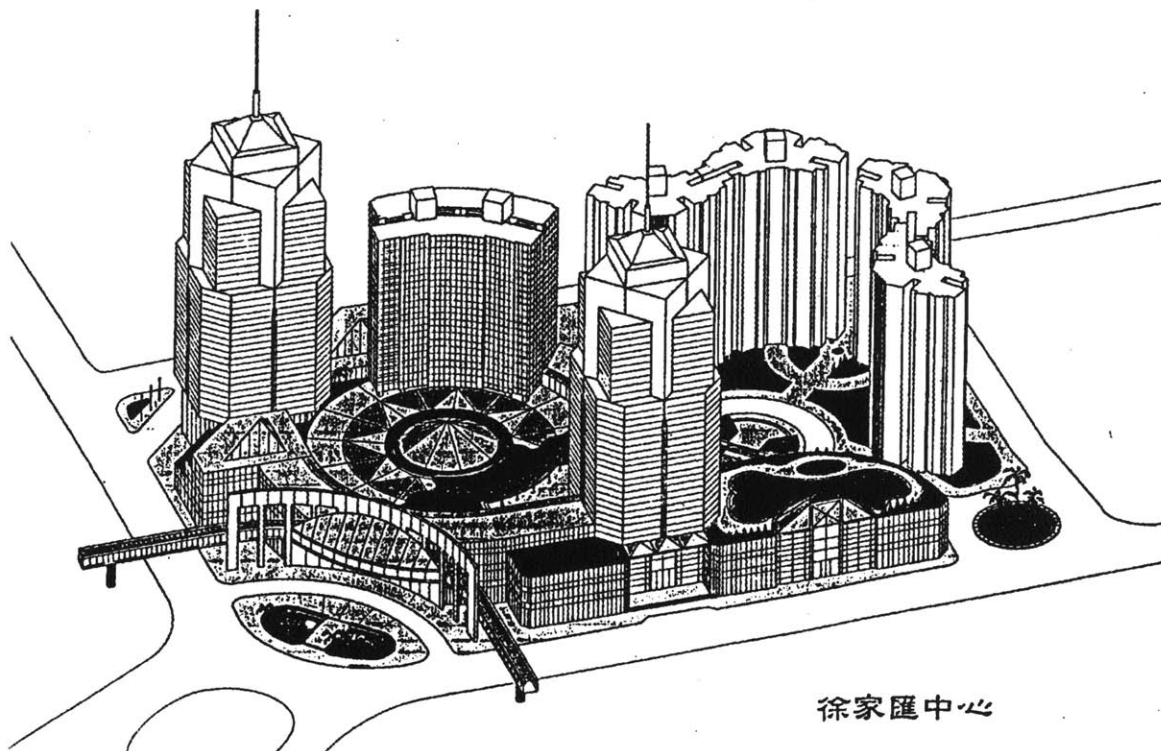


Figure 7. Perspective View of the Xujianghai Project.

The commercial section is at the southeast corner of the site, with the main retail entrance located directly opposite the underground railway station entrance. The retail portion will be six stories high with three levels of underground parking. There will be two 24-stories office towers on top of the retail platform. The residential section has six 28-stories high-rise towers. There will be landscaped areas around the towers, completed with swimming pool, club house and a tennis court. Total permitted gross area will be 309,807 square meters (3.3 million sq.ft.). 35% will be used for office space (1.167 million sq.ft.), 35% for retail (1.167 million sq.ft.), and 30% for residential (0.966 million sq.ft.). This will be the largest property development project in Shanghai.

III.C.2.b) The Land Use Right Contract

The buyers for the land use right contract were Country Link (Hang Lung and its investment partners) and Shanghai Xuhui District Real Estate Corporation (Xuhui District officials), and the seller was the City of Shanghai Land and Property Bureau. The planning requirements from the Planning Commission were:

Site area:	50,788 sq.m. (546,677 sq.ft.)
Permitted use:	Mixed-use/residential, retail and office
	Max. residential is 30%,
	Min. retail is 35%
Plot Ratio (FAR):	6.1
Max. site coverage	55%
Height limit:	none
Minimum greenery:	20% of total site
Parking requirement:	Based on planning requirement guidelines.

The plot ratio allows a maximum buildable area to be 309,807 square meters (3.3 million sq.ft.).

As with the pervious project, Hang Lung was again able to negotiate seven municipal services and a cleared site for this project. The land premium includes a land cost and demolition and resettlement cost, they are:

Site area:	50,788 sq. meters (546,677 sq.ft.)	
Land cost:	US\$ 24,629,641	15%
Demolition and resettlement cost:	US\$139,567,963	85%
Total land use right cost	<u>US\$164,197,604</u>	100%
Land cost per square meter	<u>US\$3,233</u>	

Land cost per sq.ft.	<u>US\$300</u>
Allowable buildable area	309,806.8 sq. m. (3,334,733 sq.ft.)
Land cost per buildable sq. meter	<u>US\$530</u>
Land cost per FAR sq.ft.	<u>US\$49</u>
Estimated construction cost	US\$309,392,872 ⁵²
Estimated construction cost/ FAR sq.ft.	US\$93
Total land & construction cost/FAR sq.ft.	<u>US\$142</u>

Both the land cost per square foot and the land cost per FAR square foot are higher than those in the Siping Lu project. (US\$176 and US\$39 respectively.) The cost per FAR square foot figure is a more meaningful measure of the cost versus return of a development project. For Xujiahui, this figure is 26% higher than that of Siping Lu, because of its better location and hence a higher potential return.

Ronnie Chan stated that the retail rental income for the first year was estimated to be US\$180 per square foot. This figure includes both the annual net lease and a one time key payment. Assuming that the latter is 25% of US\$180, the annual net lease from retail will be US\$135 per square foot. Comparing this last number to the calculated total land and construction cost per FAR square foot of US\$142, the return on this project can be quite attractive.

There are five steps to the payment schedule of this contract by the users (Hang Lung and its investors, and the Xuhui District) in proportion to their equity:

1. Within ten days of the signing of the contract, a deposit amounting to 15% of the land cost shall be made. That will be US\$3.7 million.

⁵² Information provided by Hang Lung, January, 1993.

2. The second payment is 50% of the demolition and resettlement cost, that totals US\$69.78 million. The payment shall be made within twenty days of the signing of the contract.
3. Within sixty days of the signing, the balance of the land cost, US\$20.93 million shall be paid.
4. Within ten days after the demolition and resettlement are completed, 40% of the demolition and resettlement cost shall be paid. That will be US\$55.83 million.
5. Finally, the balance of the contract (US\$14.76 million) shall be made within ten days after the completion of the site preparation.⁵³

III.C.2.c) The Nested Joint Venture

Back in July 1992, Chan became aware of the availability of the site for development through his contacts. He started negotiating with government officials over the land-use right contract, while planning for the financial arrangement of the development. The price for the land-use right contract including resettlement costs was determined to be around US\$164 million in the summer of 1992. When the contract was signed nine months later in 1993, the land premium was fixed at this '92 price, without adjusting for interim increases of the property value. Hang Lung and its investment partners were quite satisfied with the price of the land lease contract.

Hang Lung estimated that the land cost and the cost of development would amount to approximately US\$500 million. Given the high development potential of the site, the project represented an attractive investment for other property investors. Unlike the Siping Lu Centre, which Hang Lung developed alone; other investment partners were solicited for Xujiahui. Hang Lung, with its property arm Amoy properties, formed a

⁵³ Information from Hang Lung.

limited liability joint venture, the Country Link Enterprises Ltd., with two Hong Kong-based real estate development companies, the Henderson Land Development Co. Ltd., and the Hysan Development Co. Ltd. Hang Lung Development and Amoy Properties will be the general partner for Country Link, Henderson and Hysan are limited partners. Hang Lung will also be the project manager for the development of the Xujiahui project. The structure of the nested joint ventures is shown in Figure 8.

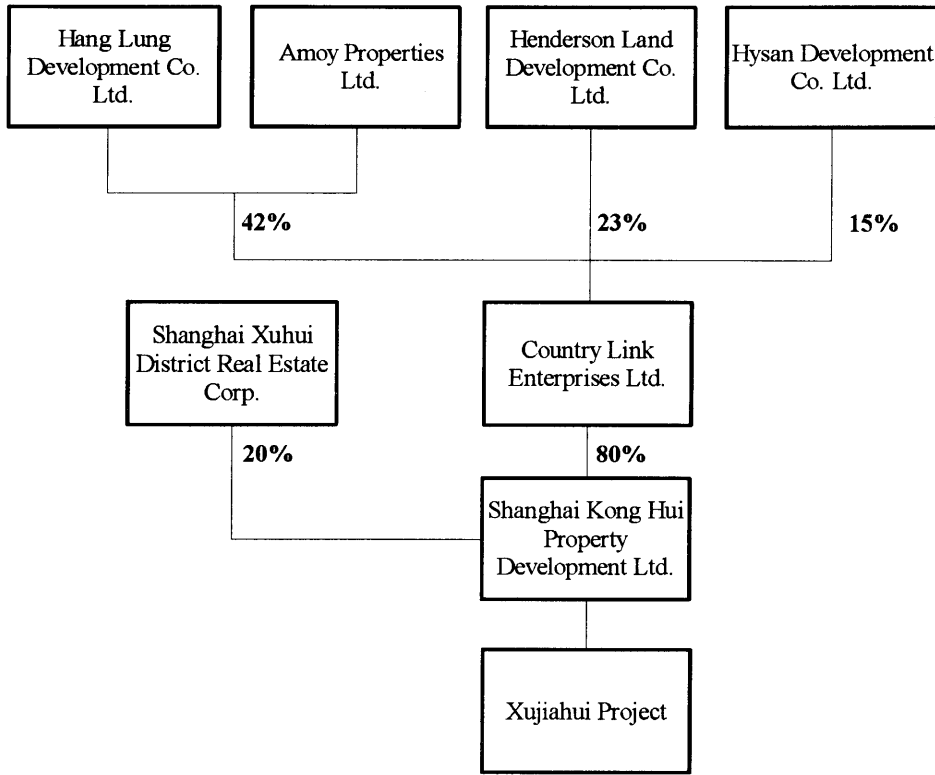


Figure 8. Structure of the Nested Joint Venture for the Xujiahui Project.

The joint venture arrangement of the three Hong Kong development corporations will amount to 80% of the total project cost, and the remaining 20% is owned by the Shanghai Xuhui District. Country Link, and the corporation representing the investment interest of Xuhui District, in turn formed an equity joint venture for the development of the Xujiahui

Centre. The equity appropriations of all four partners in the two joint ventures are as follows:

Hang Lung Development & Amoy Properties	42%
Henderson Land Development Co. Ltd.	23%
Hysan Development Co. Ltd.	15%
Shanghai Xuhui District Real Estate Corp. (District)	20%

Due to the excellent location, Hang Lung intends to retain the retail portion of the development for long-term investment to be managed by Amoy Properties. The residential and the office portions are developed for sale. Hang Lung and Amoy will share the 42% interest almost equally.

III.C.2.d) The Equity Joint Venture: Kong Hui

The Shanghai Kong Hui Property Development Co., Ltd. (Kong Hui) is the equity joint venture corporation formed between Country Link and Xuhui District. As with Siping Lu, a board of directors heads the joint venture, with seven directors from Country Link and two from Xuhui. Xuhui nominated Jin Linlin to the general manager position to manage the operation of Kong Hui, a recommendation Hang Lung accepted. Jin was the vice director of the Construction Commission of the Xuhui District. Hang Lung's China Division regards Jin highly, considering him professional, very knowledgeable with technical issues, and motivated to make the project a success.

The allocation of responsibilities among the two partners parallels that in Siping Lu, Country Link will be in charge of directing consultants in the conceptual design proposal, importing necessary products for the project, and marketing the project. Xuhui's responsibilities in the joint venture are:

- Registering and applying for license of the joint venture corporation;

- Providing the survey of the property;
- Staffing and administrating the approval process;
- Assisting the district in organizing the demolition of existing structures and resettlement of residents;
- Arranging municipal service hookups;
- Assisting Country Link in the design and approval of the project;
- Obtaining the export rights certification;
- Purchasing and leasing of equipment;
- Purchasing insurance.

The Xujiahui project further underscores the important role the PRC partners play in a joint venture arrangement. Having them take the lead in working with the Chinese Administration helps to demystify the complex process. At the same time, Hang Lung is building valuable knowledge in this exciting business.

III.C.2.e) The Design Team

In terms of buildable area, Xujiahui is over seven times the size of Siping Lu, it will be the largest development project in Shanghai. None of the design institutes in Shanghai have experience designing projects of this magnitude, therefore, Hang Lung has decided to hire a design team from Hong Kong to collaborate with a PRC design institute.

Ng Chun Man & Associates (NCM)

This is an architectural firm from Hong Kong who has prior experience working with Hang Lung on large scale projects. It will be the primary architectural team of the entire project, and the interior architect for the major spaces. NCM has made recommendations on mechanical, electrical, civil and structural engineers they have worked with to join the design team. One of the engineering teams, Maunsell, has already established operation base in Shanghai, and it is also involved with the Siping Lu project. All the engineering

firms are also based from Hong Kong, making communication among the consultants easier.

East China Design Institute

Hang Lung interviewed several design institutes, recommended by the Construction Commission, to work as PRC design collaborator with Ng Chun Man. It was most impressed with East China Design Institute. This is one of the largest design institutes in Shanghai, with a total staff of around 1,400 people.⁵⁴ Hang Lung hired East China on the basis of its high quality work.

East China Design Institute will take on an advisory role. It will review all the design drawings for codes and regulations compliance, provide recommendations to the level of design details to suit the current PRC construction standards, and to guide the design team through the approval process. In this manner, both the Hong Kong and the PRC teams learn from their collaboration. At the same time, Hang Lung is becoming increasingly more sophisticated as a foreign real estate investor in Shanghai.

III.C.2.f) The Project Schedule

The construction of the entire project will be divided into two phases. The first phase is around 60% of the project. This portion of the work runs parallel to the main thoroughfare. The completion date for the first phase is estimated to be in December of 1997, and for the second phase, to be by the end of the century. As mentioned before, Hang Lung will keep the retail portion as investment, and the rest will be for sales.

⁵⁴ Walker and Flanagan, *op. cit.*, p.82.

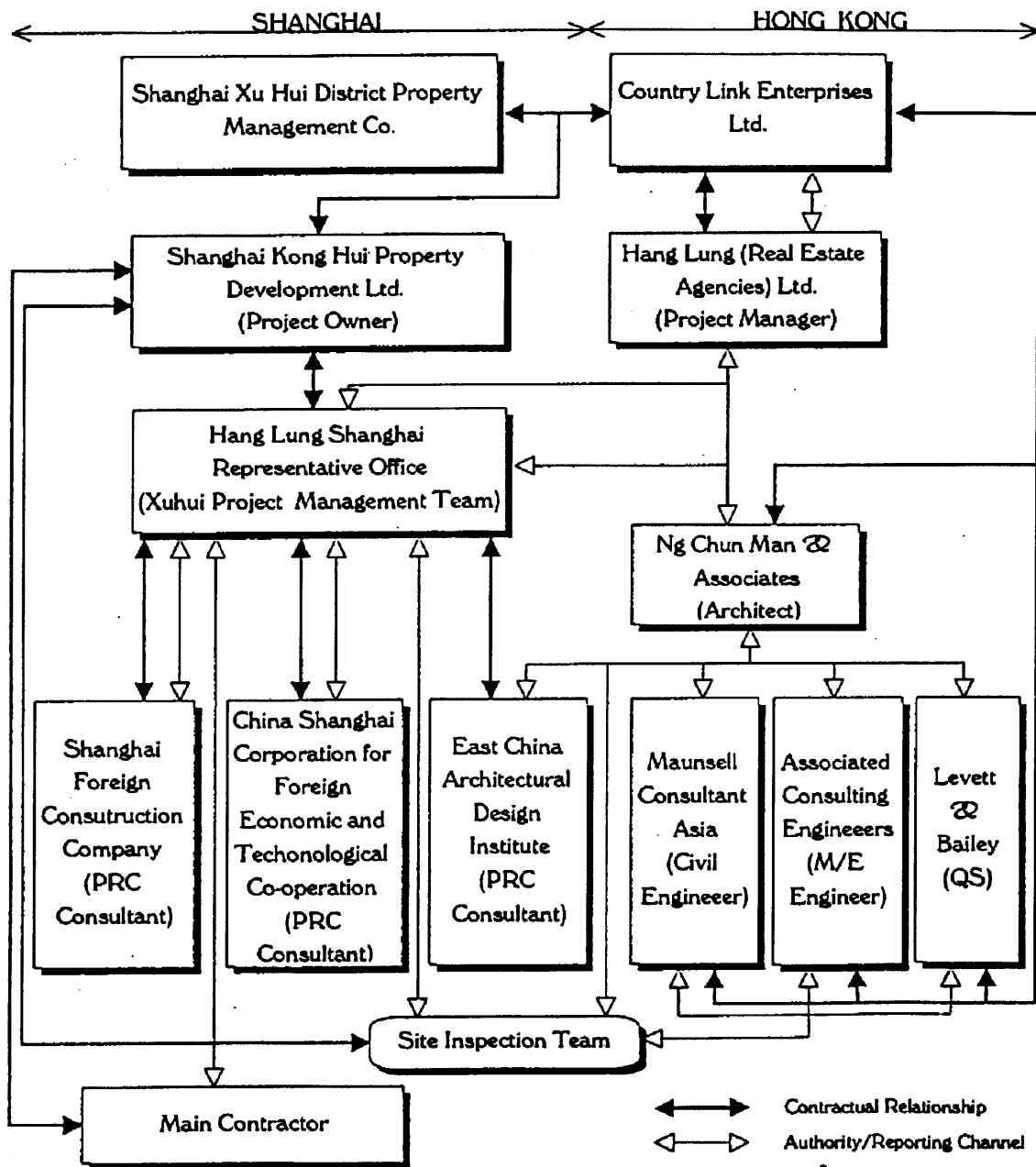


Figure 9. Contractual and Working Relationships between Key Participants in the Xujiahui Project after Incorporation of Shanghai Kong Hui Property Development Ltd. and Hang Lung Shanghai Representative Office.

III.C.3. Future Project: Nanjing Xi Lu Centre

In June 1993, Hang Lung signed a letter of intent with the city of Shanghai for a third project, the Nanjing Xi Lu Centre.⁵⁵ This project will be located in the Jing'an District along the busiest, most prestigious shopping street in Shanghai, the Nanjing Lu. Nanjing Lu stretches about six miles, and is jammed with shops, restaurants, theatres and, more recently, modern high-rise hotels such as the Mandarin, the Portman, the Hilton, and the Shanghai Centre.⁵⁶ The location of the Nanjing Xi Lu Centre can be considered exceptional in every respect, even surpassing Xujiahui in its appeal.

In September 1992, three properties within two miles of each other along Nanjing Lu were offered by the Jing'an District of Shanghai for investment proposals. Hang Lung was interested in one of the sites. However, it also recognized the development potential of the entire two-mile area, which the PRC officials had not envisioned.

Hang Lung hired an urban designer/architectural firm from the U.S.--The Jerde Partnership International, Inc.--to prepare a proposal for the two mile stretch. The final proposal Hang Lung presented to the Chinese officials was attractive, well-organized, and comprehensive. It showed how the three sites related to one another and to their vicinities, and the development potential of the individual sites and the areas around them. Most importantly, the proposal underscored the advantages of an overall design scheme versus an isolated, piece-meal design. The officials were very impressed, Hang Lung not only received a letter of intent on the property it preferred, but also earned the respect of the officials for being a responsible development company concerned about the future of the city. Figure 10 is an illustration of the proposed Nanjing Xi Lu Project, and Figure 11 shows the conceptual plan of the two miles stretch.

⁵⁵ *Lu* means "Avenue" in Chinese. *Xi* means "West."

⁵⁶ Lynn Pan, May Holdsworth and Jill Hunt, *Shanghai*, (Hong Kong: Odyssey, 1992), p. 38.

The Nanjing Xi Lu Centre will be a residential, retail, entertainment, and office complex of approximately 2 million square feet. The total development cost is comparable to that of Xujiahui, i.e. US\$500 million. The initial proposed equity split is 90% for Hang Lung, and 10% for the PRC partner. Hang Lung is also planning to team up with other investors from Hong Kong, Singapore, and the United States.

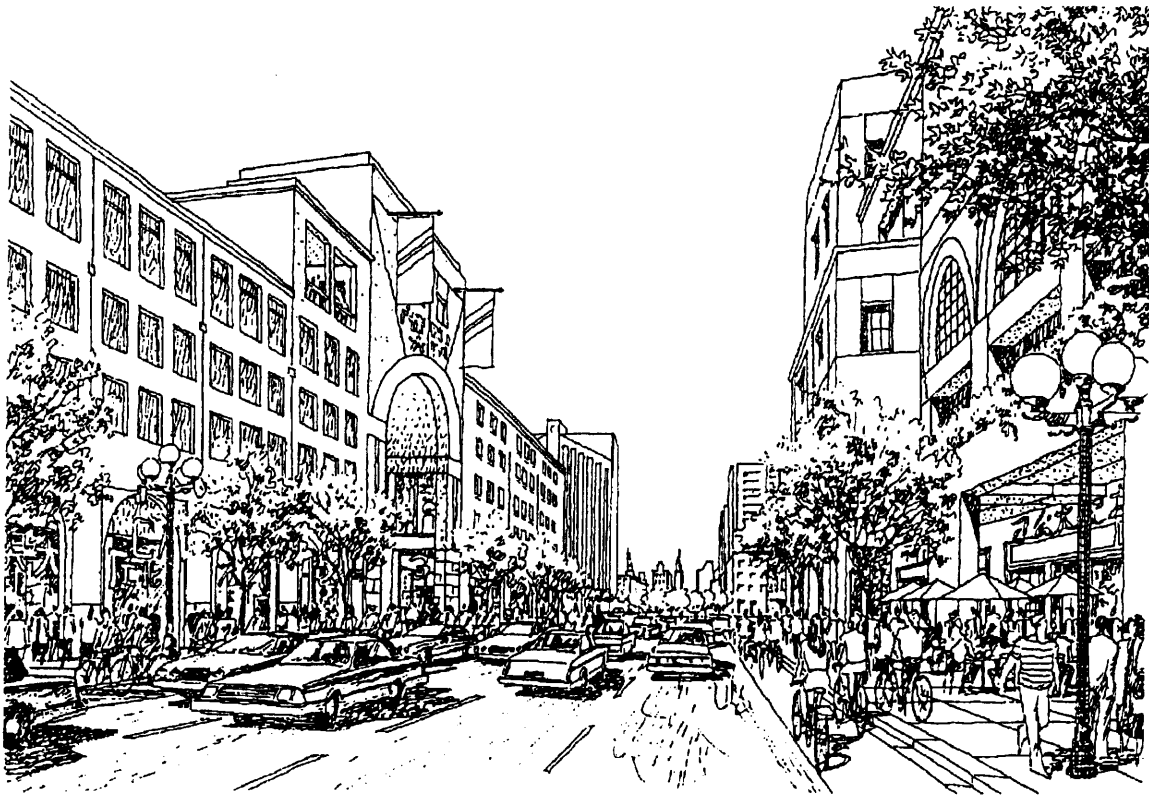


Figure 10. Perspective of the Nanjing Xi Lu Project.

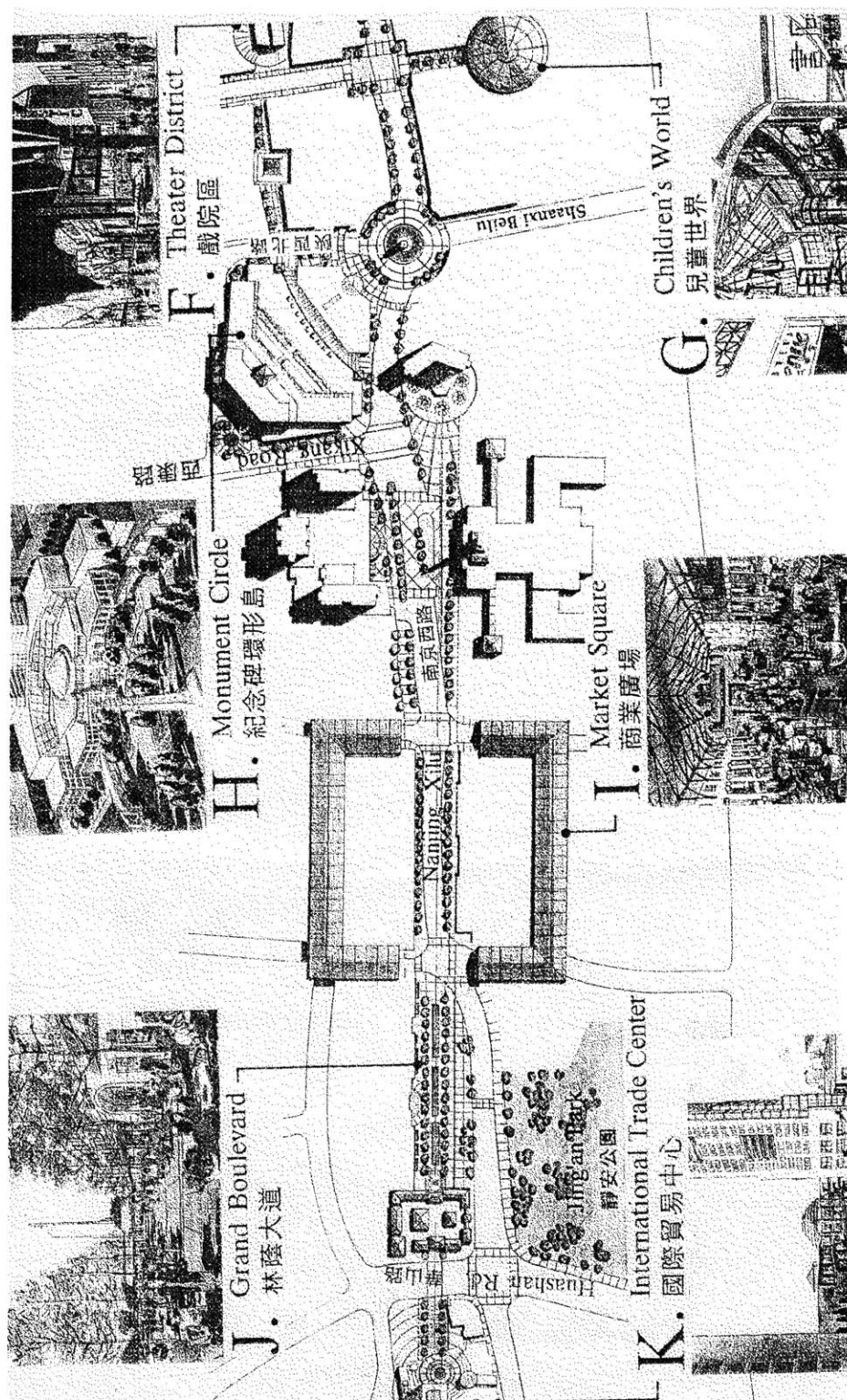


Figure 11 Proposed Conceptual Plan of Nanjing Xi Lu

III.D. SUMMARY

The chapter illustrates how a property development company from Hong Kong enters the Shanghai real estate market. Hang Lung's strategy was to use a smaller first project--Siping Lu Centre--as a test case before proceeding with a project that matched its investment target. The company gained valuable development experience along the way, and became increasingly sophisticated in its negotiations. Hang Lung also demonstrated that Shanghai is an exciting investment market full of opportunities. For confidentiality reasons, the actual returns on these projects cannot be disclosed. However, two years after these projects start operation, the company estimates the developer's profit to be substantially higher than those typically realized in markets outside China.

The joint venture development process may appear formidable and elaborate. However, with the help of PRC partners and design institutes, it is feasible to develop in China with potentially attractive returns on investment, as a number of investors have shown. With its latest project, the Nanjing Xi Lu Centre, Hang Lung demonstrated the importance of including good urban design as part of an overall development scheme, and how that influences acceptance of the project proposal.

IV. CONCLUSIONS

China represents one of the most exciting real estate investment opportunities in the world today. Its current demand for development is created by a rapidly expanding economy insufficiently served by available facilities and infrastructure. The recent real estate boom reflects rapid political and economic changes in China over the last several years; it also resulted from high-level planning aimed at focusing the growth in strategic locations along the southern and eastern seaboard of the country. An integral part of this development plan involves promotion of foreign investment opportunities. Real estate developers and investors from Hong Kong have been particularly successful in capturing these opportunities. Their favorable position stems from the close economic and cultural links with both the mainland and the West, as well as the considerable concentration of resources in this international business center.

The present case study illustrates how one of the largest development companies in Hong Kong, Hang Lung Development Co., Ltd., successfully entered the real estate market in Shanghai. The Siping Lu and Xujiahui projects illustrated that, though constrained by complex planning and approval processes, successful joint-venture relationships can be formed with partners inside China to underwrite large-scale development projects with promising investment potentials.

Several important factors are responsible for this success. Substantial financial resources must be available to participate successfully in an increasingly crowded and competitive market. Intimate knowledge of Chinese language and culture remain key prerequisites to effective communication with professionals and government officials; a subsidiary or at least a branch office of the foreign developer is a virtual necessity to provide local access and to oversee various operations.

There same factors represent barriers to entry for other investors, particularly those in the U.S. and Western Europe. As recent reports of quickening foreign investment activities in high technology and other industrial sectors indicate, however, China will continue its receptive and pragmatic attitude toward business partnerships that contribute to its modernization strategy.

V. APPENDIX A: SHANGHAI AS AN ENVIRONMENT FOR REAL ESTATE DEVELOPMENT

V.A. OVERVIEW OF SHANGHAI

On the eve of the Second World War, Shanghai was the busiest international port in Asia, and China's gateway to the world. It had evolved to this position of prominence due to a unique set of historic circumstances. Shanghai began to develop into an entry port for coastal and maritime shipping during the Sung Dynasty. At the time of the First Opium War (1840-1842), Shanghai was an important city port in the Chinese economy.

After losing the war to the British, the Chinese government signed the Treaty of Nanking. Shanghai and four other coastal ports were opened to foreign trade and residence. With its favorable location and protected harbor, Shanghai surpassed other treaty ports in the 1860s to become the leading center of foreign commerce. It was also the banking center of China, servicing the ever increasing demands of trading and enterprises.

When the People's Republic of China was founded in 1949, Shanghai, Beijing, and Tianjin became cities (Shi's) governed directly by the central government, rather than through its local provincial government.

V.A.1. Location And Transportation

Located at the flat south eastern edge of the Chang Jiang delta, Shanghai is accessible by land, river, sea, and air. From Shanghai, it is navigable along the Chang Jiang to the inland city of Chongqing in the Sichuan Province; and to other major Chinese entry ports (Qingdao, Tianjin, Dalian, Ningbo, Guangzhou, and Hong Kong) by ocean. By land, it is connected to the rest of the country by major railroad and highway systems. By air, Shanghai is served by both domestic and international airline companies connecting it to

other parts of China and the rest of the world.⁵⁷ The local airline industry is well established. Shanghai Airlines, a city-backed airline, has the reputation of being the best in service in the industry among its rivals.⁵⁸ Its competitors are among the best: Alitalia, Canadian Airlines, China Eastern Airlines, Dragonair, Japan Air Lines, Northwest Orient Airlines, Singapore Airlines, and United Airlines.

V.A.2. Land And Population

Shanghai Shi has a total area of 6041 square kilometers (2332 square miles)⁵⁹ It consists of twelve districts and nine counties. The area of all the districts combined is around 750 square kilometers (290 square miles). The remaining areas are in the counties.

The population of Shanghai at the end of 1991 is 12.872 million. 61.1% of which, that is 7.862 million people, reside in the districts. Shanghai is the most populous city in China. The average density in Shanghai is 2030 people per square kilometer (5258 people per square mile). In the districts, the average reaches 10483 people (27150 people per square mile); whereas the density in the counties averages 896 people (2320 people per square mile).

Similar to Shenzhen in Guangdong, the population in Shanghai has been increasing in the last few years due to an influx of laborers from the poorer provinces. They come because of the growth differential between the prosperous coastal regions and the less developed hinterland, hoping to find a better life in the big cities. The gap between the coast and the western provinces is growing faster than the government has anticipated, bleeding inland areas of capital and personnel.⁶⁰ Not everyone who comes is less educated. Many of the

⁵⁷ *Shanghai Shiqu Dituce*, (Shanghai: City of Shanghai Department of Surveyors, 1990).

⁵⁸ "Look, up in the sky--a swarm of Chinese airlines", *Business Week*, (May 17, 1993).

⁵⁹ *Shanghai Shiqu Dituce*, op. cit.

⁶⁰ "Economic boom, social stresses rock China." *The Boston Globe*, (May 16, 1993), p. 12

brightest students leave their hometowns to attend China's top universities. They then go to work on the coast, causing a brain drain of the inland provinces, and depriving their homestates the possibility of transforming themselves into more productive areas.

The following table shows the density of the different districts and counties in Shanghai. The location of the three Hang Lung's projects, Siping Lu (Hongkou District), Xujiahui Centre (Xuhui District), and Nanjing Xi Lu (Jingan District) are high-lighted as a point of information. Of the three projects, Nanjing Xi Lu is located in the most populous district.

Table II Area and Population Density of Districts and Counties in Shanghai⁶¹

DISTRICT	AREA SQ.KM	DENSITY	COUNTY	AREA SQ.KM	DENSITY
HUANGPU	21.07	33208	SHANGHAI	377.78	1107
NANSHI	27.92	28628	JIADING	483.75	1053
LUWAN	8.05	54646	CHUANSHA	44505	1389
XUHUI*	46.64	15667	NANHUI	687.66	1019
CHANGNING	28.88	19997	FENGXIAN	687.39	758
JINGAN*	7.62	58937	SONGJIANG	605.64	826
PUTUO	29.88	25833	JINSHAN	586.05	945
ZHABEI	27.95	24225	QINGPU	675.54	674
HONGKOU*	23.48	35860	CHONGMING	1041.21	704
YANGPU	59.63	18276			
MINHANG	43.08	3521			
BAOSHAN	425.18	1484			

V.A.3. Employment

According to the 1990 census, 6.8% (872,000 people) of the population in Shanghai are college educated, and 20.2% (2,606,000 people) are high school graduates. Comparing to

⁶¹ Tan, '92; *Shanghai Real Estate Market*, *op. cit.*, p. 3-4.

the rest of the country, Shanghai has the second best educated population, the best educated one is in Beijing.

From the same census, the employment data of the residents of Shanghai breaks down into the following three categories: 12.4% in agriculture, 58.1% in industries, and 29.5% in commercial. Compare to the 1982 census data, both the industrial and commercial percentages have increased, and agricultural have declined. This may imply that with the advance in agricultural technology, less labor is needed in agriculture even when the population has increased.

V.B. SHANGHAI'S ECONOMIC DEVELOPMENT

Shanghai is the largest population and financial center in China. It plays a crucial role in the economic development of the country. It is included in the original fourteen Special Coastal Cities to be revitalized. In 1990, the Chinese government declared its intent to develop and open the Shanghai Pudong New Area. The decision aroused profound repercussion domestically and abroad. Many influential transnational companies came to Pudong to invest. By the end of 1991, the foreign funded joint ventures in this new area totalled 143. The development of Pudong has brought Shanghai's economy to a new level.⁶²

In 1991, the economic growth in Shanghai in industrial, commercial, retail, and real estate investments had all reached double digits. The Gross Domestic Product (GDP) in Shanghai was 82.5 billion yuan (US\$14.35 billion)⁶³, of which 5.106 billion yuan (US\$888

⁶² *Guide to the Development and investment of Pudong Shanghai 1991*, (Hong Kong: Economic Information & Agency of Hong Kong, 1991).

⁶³ Excerpt from "China's yuan: Sell," *The Economist* (March 20, 1993), p.88.--There are three exchange rates in China. The official rate is 5.75 to the dollar (as of July 1993). There is the swap-centre rate of around 8.2 to the dollar. 80% of the currency deals are done through the swap-centres. Lastly, there is the black market rate, which is around 10 to a dollar.--Throughout this thesis, the official exchange rate of 5.75 to a dollar is used.

million) were from the Pudong area. Comparing to 1990, the annual increase of GDP in Shanghai was 6.2%, and was 15.3% in Pudong. Regional total income was 68.7 billion yuan (US\$8.86 billion), up 6.6% from the pervious year. Both per capita GDP (US\$1,115) and the per capita income (US\$300) were higher than that of the averages of the country in 1991.⁶⁴

1. Industrial Development. Shanghai has a multifaceted cross section of industries. Its industries range from heavy to light, technology intensive to labor intensive; and employed 3.78 million people in 1991. Total industrial output was 194.7 billion yuan (US\$33.86 billion). This represented 6.9% of China's total industrial output. The ratio of heavy to light industries was about one to one.

Compared with the national average, productivity per industrial worker was 47.8% higher than the national average of 33,136 yuan (US\$5,763). The contribution of Shanghai industrial productions were quite impressive. Shanghai produces 27.8% of the country's bicycles; 14.2% of its steel; 9.9% of its iron ore; 13.8% of its man-made fibre; 17.45 of its televisions; 13.95 of its refrigerators; and 13% of its washing machines.⁶⁵

The industrial areas are distributed throughout the city. The city of Shanghai has no zoning code. Integrating the national economic policy and urban design guidelines, Shanghai has been developing new industrial districts and satellite towns outside the existing city proper. The idea is to diversify industrial nodes away from the city, and to assist in the development of the surrounding counties.

⁶⁴ Tan, "92: *Shanghai Real estate Market*, *op. cit.*, p. 6.

⁶⁵ *Ibid.*, p.5.

- 2. Agricultural Industry.** Favorable climatic conditions allow for substantial agricultural output. In 1991, vegetables, dairy products, and fisheries were sufficient to meet the city's demand. For a population of close to 13 million, these are important figures. Total agricultural output was 51 billion yuan (US\$8.87 billion), a 21.8% increase from the year before.
- 3. Commercial And Retail.** The commercial and retail industry of Shanghai is renowned for its huge volume, wide varieties, and excellent quality. The total volume of retail in 1991 was 40.2 billion yuan (US\$7 billion), a 13.9% increase from 1990. Compared to the rest of China, Shanghai's retail volume represented 4.3% of that of the entire country.
- 4. Finance.** In 1990, there were four foreign banks that had branch banks registered in Shanghai. As of 1991, the number of foreign branch banks had increased to twelve. In addition 37 foreign banks had local offices in Shanghai. These offices were represented by twelve countries. There were 18 from Japan, 4 from France, 3 from the U.S., 1 from Sweden, 2 from Italy, 1 from Belgium, 2 from Hong Kong, 1 from Canada, 1 from Germany, 1 from England, 1 from Saudi Arabia, and 2 from Holland. These foreign banking activities indicate the high volume of foreign investment in Shanghai, and their interest and confidence in its future investment opportunities.⁶⁶

The first securities market in China was established in Shanghai in 1990. Jiang Wang, lecturer at the MIT Sloan's School of Management, described the capital markets in China as followed:

"As of 1992, 29 stocks with a total value of 60 billion yuan (US\$10.43 billion) and a weekly volume of 70 million

⁶⁶ Tan, '92, *Shanghai Real Estate Market*, op. cit., p.16.

shares were traded on the Shanghai market. Only 9 issues had B shares available for purchase by foreigners. B-share performance has been very volatile. While these markets are tiny at the moment, they have tremendous potential. Companies have an urgent need to for capital, and they have government approval to go to market. Returns to the A shares have been volatile but high, around 80%."67

5. Trade And Exports. Shanghai's largest trading partner is Hong Kong and Macau.

The top three areas for export in 1991 were Hong Kong and Macau, Japan, and the U.S. The volume of export to these countries were US\$1,100 million (an increase of 4.3%), US\$910 million (an increase of 20.5%), and US\$811 million (an increase of 8.8%) respectively. Over 60% of the merchandise for export are textile products; 27% are heavy industrial products; and 12.5% are agricultural products. The total export and import volume from Shanghai in 1991 was US\$20.4 billion (an increase of 18.1%), of which US\$10.1 billion (an increase of 17.2%) was in export.⁶⁸ In 1979, one of the motives behind the open door policy was to follow the Four Mini-Dragons in bringing prosperity to their countries through trade. Shanghai has gradually been achieving that.

6. Foreign Capital And Investments. Shanghai utilized US\$943.2 million of foreign capital in 1991. They were in the forms of direct loans (US\$460 million), direct foreign investment through joint ventures (US\$450 million), and others. Foreign capital from joint venture was up 20% from 1990. (See Table III) The detail of the joint ventures are listed in Table IV. Among the different industries, majority of the joint ventures in 1991 were in industrial developments, which added up to 75% of the total foreign venture sum. 14% (US\$63 million) of the total joint venture were in real

⁶⁷ Wang, Jiang, "Investment in Capital Markets in China", Members' Meeting, June '93, MIT Center for Real estate.

⁶⁸ Tan, '92, *Shanghai Real Estate Market*, *op. cit.*, p.18.

estate developments; the number of real estate contracts was 13, therefore each contract averaged US\$4.8 million. The land-use right contract signed by Hang Lung for the Xujiahui project in February 1993 was US\$ 160 million, that is more than twice the real estate activities in the entire year of 1991.⁶⁹

Table IV also indicates the number of joint ventures signed by country, a large percentage of the foreign investors were from South East Asia and the U.S. In 1991, investors from Hong Kong and Macau totaled 46.8%; from Japan, 13.4%; and from the U.S., 10%. U.S. investors invested US\$50 million in Shanghai in 1991. If 14% were used for real estate development as the average figure indicated, that would have been US\$7 million, a not very large sum for real estate.

Table III Foreign Capital Utilization in Shanghai, 1991⁶⁹

	NO. OF CONTRACTS	CONTRACTED SUM (U.S.SMM)
1. Direct Loans	50	459.56
Foreign Banks	43	370.26
Bonds	6	51.57
Other Loans	1	37.73
2. Foreign Investmt.	365	450.01
Equity J.V.	292	335.61
Co-operative V.	23	6.61
Foreign Ventures	50	107.74
3. Other Investmt.	94	33.63
Total	509	943.20

⁶⁹ Tan, '92, *Shanghai Real Estate Market*, op. cit., p. 19.

Table IV. Foreign Joint Ventures in Shanghai as of 1991

	# OF CONTRACTED JOINT VENTURES		CONTRACT AMOUNT (US\$ MILLION)	
	IN 1991	CUMULATIVE	IN 1991	CUMULATIVE
1. Types of J.V.				
Equity J.V.	292	1035	335.61	1777.21
Co-operative V.	23	148	6.66	1129.76
Foreign Owned	50	94	107.74	424.95
2. Business Type				
Agricultural	4	12	10.16	12.57
Industrial	331	1055	338.25	1485.20
Construction	2	27	0.21	14.61
Transportation	2	14	9.92	31.08
Commercial	2	36	2.96	28.85
Real Estate	13	112	63.33	1709.43
Others	11	21	25.18	50.17
3. By Country				
U.S.A.	35	156	50.07	764.15
H.K./Macau	171	619	127.74	902.17
Singapore	5	36	0.33	80.03
Japan	49	176	131.69	538.67
England	4	21	5.62	72.61
Australia	3	10	3.28	9.29
Germany	1	12	10.06	164.42
Canada	7	16	3.54	36.10
Denmark	0	1	0.06	0.11
Others	90	230	117.62	764.66
Total	365	1277	450.01	3331.91

V.C. THE REAL ESTATE MARKET IN SHANGHAI

In 1987, the city of Shanghai has adopted new regulations for the real estate industry. The real estate market is divided into two categories, one for domestic offerings, and the other

for foreign offerings. Domestic offerings are reserved for the PRC citizens, approved overseas Chinese, and PRC governmental agencies. The foreign offering category is established to encourage foreign enterprises to invest in real estate in Shanghai. It is legal for foreigners to engage in the buying, selling, leasing, assigning, and mortgaging of Shanghainese real estate. The establishment of this law opens the door of the real estate market to foreign investors.⁷⁰

In 1991, the total real estate investment from both PRC and foreign capital was 2.6 billion yuan (US\$452 million), an increase of 14.8% from 1990. New construction starts in 1991 were 2911, an increase of 43% from 1990. This volume of real estate activities was the highest in Shanghai since 1949. Within the different types of industries, industrial real estate developments were 86% of the total of all industries. The following table shows construction by industry.

**Table V. 1990 to 1991 Shanghai Real Estate Construction By Industry
(million yuan)⁷¹**

INDUSTRY	1990	1991	% INCREASE
Industrial Development	11,880	11,750	(1.1)
Construction Business	181	228	26.0
Transportation/Communication	116	207	78.4
Commercial/Retail/Restaurants/Warehouse	393	449	14.2
Real Estate Management/Public Works	230	389	69.1
Education/Art and Culture/Broadcasting	475	501	5.5
Scientific Research/Integrated Technology	148	178	20.3

⁷⁰ Tan, '92, *Shanghai Real Estate Market*, *op. cit.*, Section 5.

⁷¹ *Ibid.*, p. 23.

Table VI. Average Cost for New Constructions
(Yuan/sq. m.)⁷²

	1989 IN Y/SM	1990 IN Y/SM	1991 IN Y/SM	1991 IN \$/SF
Total Average	523	679	814	13.38
Factory	729	660	1018	16.74
Warehouse	404	515	549	9.03
Office	575	819	1516	25.00
Commercial	362	966	403	6.63
Public Service	695	1522	1554	25.55
Residential	469	509	629	10.34
Education	414	421	498	8.27
Sports	793	812	1002	16.48
Medical	763	742	746	12.27
Research/Lab.	616	640	856	14.07
Others	505	594	1109	18.23

V.C.1. Public Works And Infrastructure Improvements

In the last few years, Shanghai has undertaken some ambitious public works projects to revitalize the city. They include new bridges, a forty-seven kilometers ring road, reconstruction of the Bund, new subway system, airport extension, purification of the Huangpu River and the Suzhou Creek, new power plant, three natural gas constructions, and a new hydro-electric sub-station. The volume of public works and infrastructure improvements totalled 6.1 billion yuan (US\$1.06 billion) in 1991, an increase of 30% from 1990. The increase in activities illustrates the governmental policy of modernizing

⁷² Tan, '92, *Shanghai Real Estate Market*, *op. cit.*, p.23.

Shanghai. In April of 1993, Shanghai announced that it planned to concentrate on environmental improvements of the city in the 90's.⁷³ Its goals were to create a well-landscaped city with sound basic infrastructures, clean air, fresh water, and made environmental protection one of its main target.

V.C.2. Residential

Shanghai continues to support new residential construction projects. The total residential construction in 1991 was 3.6 billion yuan (US\$626 million), adding 4.78 million square meters (51.5 million sq.ft.) to the existing inventory. This was an increase of 35.8% of investment compared to 1990. The average living standard of the average Shanghainese has gradually improved from 4.7 square meter (50.6 sq.ft.) per person in 1982 to 6.7 square meter (72 sq.ft.) in 1991.⁷⁴ The government target is to reach 8 square meters (86 sq.ft.) per person by year 2000.⁷⁵ Comparing these figures to western standards is meaningless, as Shanghai has a much higher population density than most countries.

In 1991 the total volume of sales in the market price category was 640,700 square meters (6.9 million sq.ft.), of which 80% were sold to commercial enterprises, and 20% to private individuals. Sale price per square meter ranged from 630 yuan to 2172 yuan (or from US\$10.18/sq.ft. to US\$35/sq.ft.) depending on the location. The lower number was for units in the outlying county areas. These market price residential projects were developed by both PRC (16%), and by joint venture (84%) real estate development companies.⁷⁶ Both of Hang Lung's projects in Shanghai have residential portions in them, they are developed for market price sales. However, Hang Lung's projects will be priced

⁷³ "Shanghai: 8 billion yuan in environmental improvements", *Ta-Kung-Pao*, (April 13, 1993).

⁷⁴ Tan, '92, *Shanghai Real Estate Market*, *op. cit.*, p.29.

⁷⁵ Zhang Yuanrey *et al*, *Directory of Real Estate Development in China*, (Heilong jiang: Heilong jiang Science and Technology Press, 1991), p. 165.

⁷⁶ Tan, '92 *Shanghai Real Estate Market*, *op. cit.*, p. 92.

considerably higher than projects mentioned here, because their average construction costs are higher. (The average construction cost is \$106/sq.ft. for Siping Lu and \$142/ sq.ft. for Xujiahui).

V.C.3. Commercial Office

Since 1983, there were two distinct concentrations of construction activities in the office market. The first one was around 1986, and the second one peaked in 1991. Vacancy rate reached 45% in 1986, and dropped to 9% two years later. The vacancy rate in 1991 was 29%. (See Table VII and Figure 13) This figure appears high, but may be explainable. Table VIII lists the commercial office buildings developed between 1983 to 1991, and three that will be constructed in 1992 to 1993. Vacancy rate shown refers to the office portion only. Buildings G was at an undesirable location, and Building I just came on the market at the time the table was prepared.⁷⁷

Rent per square meter per month in 1991 ranged from 38.5 yuan to 209 yuan, with an average of 152 yuan. (This is equivalent to US\$7.47/sq.ft./yr to US\$40.5/sq.ft./yr, with an average of US\$29/sq.ft./yr.) Figure 12 shows the rental index from 1985 to 1991. According to the "92, *Shanghai Real Estate Study*", the top six tenants in terms of amount of space rented were from the following countries: Japan; Europe (except England); Hong Kong, Macau and Taiwan; China; U.S.A.; and England.⁷⁸

Land lease in the earlier years averaged twenty years. (See Table VIII) Projects that were developed by the city of Shanghai would not have required a land lease. Developers have been able to negotiate much better terms in the later years, land lease for commercial

⁷⁷ *Ibid.*, p. 50.

⁷⁸ *Ibid.*, p. 53.

office buildings is currently set at 50 years. Buildings J and K, which are under the 50 years land lease, are both for rental and for sale. Seven out of the eleven projects that are listed, have a residential portion. With the exception of two, nine of the buildings are high rise. Buildings that were constructed before 1989 were 90 to 100% occupied. The ones that just came on the market in 1991 were between 16 to 75% occupied.

According to the same report, the Shanghai real estate office market has a large supply of space on the upper end (above \$27/sq.ft.), but insufficient on the middle (\$15 to \$20/sq.ft.) and lower (\$10 to \$15/sq.ft.) ends to meet the demand. In the coming years, the number of properties designated for office development in the more desirable downtown area will be limited; and it advised the developers to concentrate their development on the lower end of the market.

V.C.4. Hotels

By the end of 1991, Shanghai has 85 hotels with 22,336 rooms available for occupancy, this was a 4.6% increase from 1990. Of the 85 hotels, 49 were reserved for foreign visitors. Hotel occupancy rate was 60% in 1991, consistent with the pervious years. Daily room rates at the top hotels ranged from US\$75 to US\$135. All the hotels combined brought in 1.6 billion yuan (US\$278 million), up 38% from '90. 45% of the income came from room rental, 34% from restaurants, and 10% from retails. 65 of the hotels were financed by PRC real estate development companies, 12 were developed by equity joint ventures, 7 by co-operative joint ventures, and one was wholly foreign owned (the Nikko Longbai Hotel).⁷⁹

⁷⁹ Tan, '92, *Shanghai Real Estate Market*, *op. cit.*, p.57-62.

Table VII. 1983 to 1993 Commercial Office Rental Market⁸⁰ (square meters)

YEAR	STOCK	NEW SUPPLY	TOTAL AVAILABLE	ABSORPTION	OCCUPANCY	VACANCY	VACANCY RATE %
	A	B	C	D	E	F	G
1983	3318	3318	3318	3318	3318	0	0
1984	5142	1824	1824	1824	51420	0	0
1985	21011	15869	15869	12800	17942	3069	14
1986	46485	25474	28543	7414	25356	21128	45
1987	58123	11637	32766	24883	50239	7883	13
1988	58511	388	8271	2636	52876	5635	9
1989	75511	17000	22635	5686	58563	16948	22
1990	108011	32500	49448	15387	73950	34061	31
1991	140235	33069	67130	25060	98165	42070	29
1992*	160335	20100					
1993*	166175	5840					

A=A'+B; C=B+F', D=C-F, E=E'+D, F=A-E, G=F/A (%); A',E',&F' are figures for the previous year.

(* Estimated)

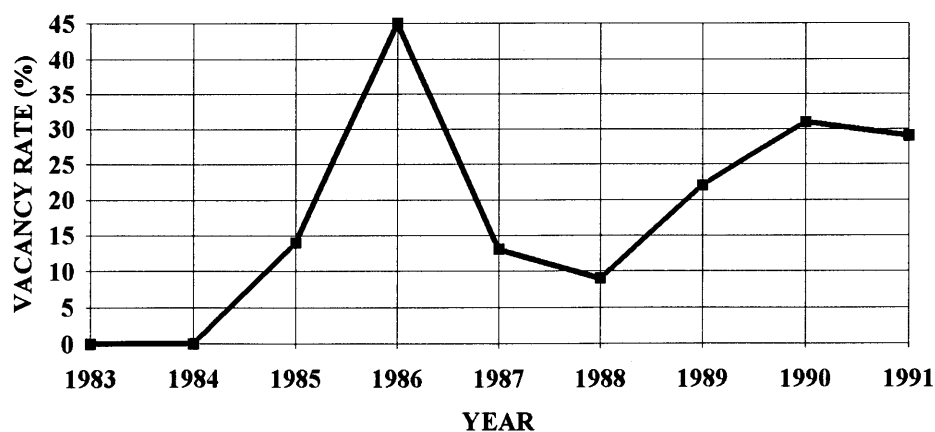


Figure 12. Commercial Office Vacancy Rates from 1983 to 1991.

⁸⁰ Tan, '92, *Shanghai Real Estate Market*, op. cit., p. 50.

Table VIII. 1983 to 1993 Commercial Office Building in Shanghai⁸¹

Bldg	Rent/ Sale	Dev By	Land Lease	Year Start	Gross sq.m.	Renta l sq.m.	Levels	Retail sq.m.	Rest. sq.m	Resid Units	Vac. Rate
A	Rent	PRC	-	1983	8444	5142	5	0	0	0	0
B	Rent	CV	20	1985	30049	21212	30	210	1550	0	10
C	Rent	PRC	-	1986	36243	21812	27	107	2119	40	10
D	Rent	JV	10	1986	14400	9500	5	1855	2218	0	0
E	Rent	JV	22	1989	27000	17000	23	0	0	0	10
F	Rent	JV	18	1990	185000	23800	48	6400	3000	472	25
G	Rent	PRC	-	1990	43200	8700	31	510	1350	219	54
H	Rent	JV	17.5	1992	36484	2400	30	1400	1400	144	-
I	Rent	JV	18	1991	90000	33069	37	175	3270	86	84.2
J	Rent & Sale	F	50	1993	72345	5840	29	4376	0	388	-
K	Rent & Sale	F	50	1992	30000	17700	28	1000	1400	32	-

Notes: PRC=People's Republic of China; CJ=Co-operative Joint Ventures; JV=Equity Joint Ventures; F=Wholly Owned Foreign Ventures.

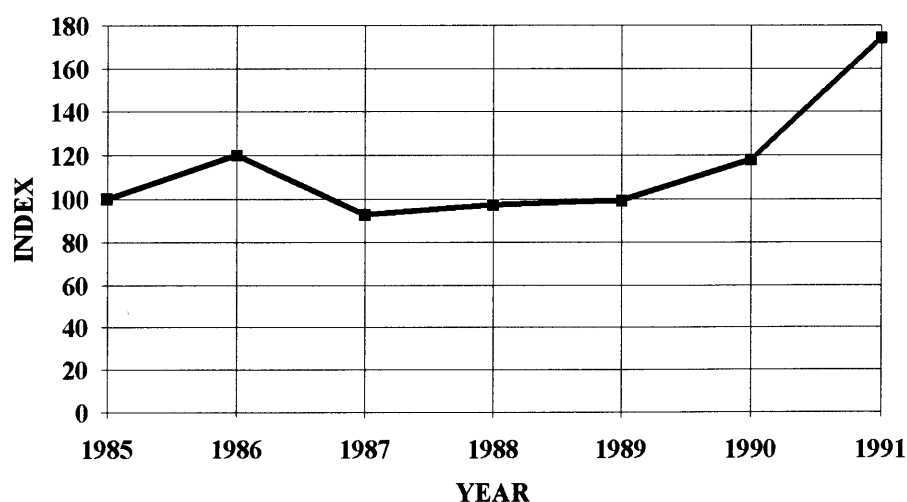


Figure 13. Commercial Office Building Rental Index from 1985 to 1991.⁸²

⁸¹ Tan, '92, *Shanghai Real Estate Market*, op. cit., p. 48.

⁸² Ibid., p.57.

**VI. APPENDIX B: HANG LUNG DEVELOPMENT CO., LTD.
BALANCE SHEETS⁸³**

At 30th June, 1992
(Expressed in Hong Kong dollars)⁸⁴

	1992	1991
	HK\$M	HK\$M
Assets Employed		
Fixed assets	19,916.3	14,824.8
Interest in associated companies	1,065.5	643.4
Loans and investments	154.5	36.0
Current assets	6,819.5	5,713.0
	<u>27,955.8</u>	<u>21,217.2</u>
Current liabilities	(3,552.5)	(4,284.0)
	<u>24,403.3</u>	<u>16,933.2</u>
Financed by		
Share capital	1,144.3	1,144.2
Reserves	10,630.8	7,766.9
Shareholders' funds	11,775.1	8,911.1
Minority interests	9,509.4	6,014.4
Long-term liabilities	3,105.4	1,997.8
Deferred taxation	13.4	9.9
	<u>24,403.3</u>	<u>16,933.2</u>

⁸³ *Hang Lung Development Company, Ltd. Annual Report 1991-1992*, p.34.

⁸⁴ US\$1 = HK\$7.8

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